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STATUS OF THE HOUSING SECTOR

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

NEW CONSTRUCTION, SALES AND MORTGAGE FINANCING ASPECTS OF THE HOUSING INDUSTRY

FEBRUARY 14, 1983

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CONTENTS

MONDAY, FEBRUARY 14, 1983

	Page
Opening statement of Chairman Garn	1
Statement of Senator Hawkins	3

WITNESSES

Samuel R. Pierce, Secretary, Housing and Urban Development	4
Prepared statement	4
Economic trends	4
FHA activity	6
Housing credit	7
Housing affordability	8
Redirection of FHA	8
Conclusion	9
Heading for full recovery	10
FHA applications break record	11
Using pension funds assets	14
Reducing housing costs	14
Pension funds mortgage investment	17
Mortgage revenue bonds	18
No rental housing shortage	20
Priority to inadequate or substandard housing	23
Pension money under lock and key	25
Mortgage revenue bonds	27
Foreclosures	30
Emergency assistance	30
Impractical proposal	31
Richard T. Pratt, Chairman, Federal Home Loan Bank Board	34
Prepared statement	35
Housing recovery	35
The economy and housing in 1983	41
Thrift contribution to recovery	44
Foreclosure issues	52
Secondary market issues	59
Conclusion	64
Charts:	
1. Housing starts and permits	35
2. New single family home sales	36
3. Housing completions	37
4. Inventory of unsold homes	37
5. Month's supply of single family homes at current sales rate	38
6. Existing single family home sales	38
7. Mortgage activity of FSLIC-insured savings and loan associations	39
8. Savings and loan profitibility	45
9. Shares of originations of conventional long-term mortgages on 1 to 4 family dwellings	47
10. Percentage distribution of net changes in residential mortgages by types of lender	47
11. Mortgage loans and contracts 60 days or more delinquent	53
12. Annualized rates of foreclosures by S&L's balances and number of loans	54

Richard T. Pratt, Chairman, Federal Home Loan Bank Board—Continued Page
Positive signs of recovery 65
Foreclosures and delinquencies 66
David O. Maxwell, chairman and chief executive officer, Federal National Mortgage Association, Washington, D.C 67
Prepared statement 67
The 1982-1983 housing recovery 68
Conditions necessary for continued recovery 68
Increasing importance of the secondary market 69
Requirements for recovery 72
Role of FNMA 73
Looking ahead 74
Kenneth J. Thygerson, President and Chief Executive Officer, Federal Home Loan Mortgage Corporation, Washington, D.C 74
Prepared statement 75
Overview 75
Recent trends in housing activity 75
Housing finance 76
The housing recovery and secondary mortgage markets 77
Responsiveness and innovation at Freddie Mac Conclusion 79
Assisting the housing market 83
Summary 84
Panel discussion:
New legislation lifesaving tool 85
Financing "A Large Deficit" 87
Future housing demands 88
MMF's rate drop 89
New funds into thrift institutions 91
Dealing with the annual deficit 93
Is the worst over? 95
Competition for funds 96
Attractive mortgage rates 97
Mortgage insurance 98
James M. Wooten, president, Mortgage Bankers Association Lomas and Nettleton, Co., Washington, D.C 100
Prepared statement 100
Economic outlook 100
The secondary mortgage market 101
Limitations on FHA mortgage insurance and GNMA-MBS guaranty activity 102
FHA 102
FNMA purchases of FHA/VA loans 103
Removal of mortgage loan purchase limits for FNMA and the FHLMC 104
Potential developments for the secondary market 105
Emergency mortgage foreclosure relief 106
FHA processing of loan applications 108
Recovery not of normal strength and duration mortgage assistance program 109
Herbert Gray, president, Mutual Savings Bank Association, Washington, D.C 111
Outlook clouded by uncertainties 111
Liberalization of the IRA program 112
Prepared statement 113
Short-run housing outlook 113
Longer-run prospects 114
Condition and prospects of savings banking 115
The Garn-St Germain Act and housing 116
Leon T. Kendall, president, Mortgage Insurance Companies of America, Washington, D.C 117
Potential home buyers encouraged 117
Recommendations 118
Prepared statement 119
Current outlook for housing and mortgage finance 120
Exhibit—Interest rates and affordability 120
Actions for market improvement 122
Appendix 124
Critical review of the role of housing, 1972-1982 124

Leon T. Kendall, president, Mortgage Insurance Companies of America, Washington, D.C.—Continued
Prepared statement—Continued
Appendix—Continued
Critical review of the role of housing, 1972-1982—Continued Page
Inflation alters uses of a home 124
Speculation in housing 125
1981-1982 lessons 125
Changing role of government 126
Outlook for the 1980's 126
Leonard Shane, chairman, U.S. League of Savings Institutions, Washington, D.C. 127
Cautions to be expressed for the future 128
Areas to examine for solutions 130
Prepared statement 130
A revolution in the marketplace for savings 131
The threat of Federal deficits to homeowners by 132
Housing demand and available savings 132
Home prices and affordability 133
Current market conditions 133
Thrift diversification and a sustainable housing recovery 134
Secondary market agencies' role 135
Alternative housing credit sources 135
Summary and conclusion 136
Panel discussion:
Trillions of dollars needed 137
Looking for new sources of mortgage money 138
Difference in credit availability 139
Predatory pricing 140
One day accounts 141
Changes must be made 143
Seeing a change in the American dream 145
Harry Pryde, chairman, National Association of Homebuilders Washington, D.C. 146
Housing recovery is fragile, but real 147
Reducing projected deficits 148
Prepared statement 150
Status of the housing industry 151
Outlook for the housing industry 153
Budget 154
The delivery system 157
Mortgage credit 157
Home mortgage access corporation 158
The housing product 159
Production capacity 160
Legislative priorities 161
Tables:
1. New housing activity 162
2. Housing trends 163
3. Number of unemployed 164
4. Contract interest rate 166
5. Federal subsidized housing starts 167
6. NAHB econometric forecasts housing starts 168
7. Forecast assumptions 170
8. Comparison of Reagan budget with CBO projection 171
9. Budget authority by functions 172
10. Credit market funds raised 174
11. Budget authority for construction and housing 176
12. Total mortgage funds advanced 179
13. HUD field office jurisdictions 180
14. Selected characteristics of new one family homes 182
15. Median price of new and existing single family homes 183
Appendix A:
NAHB 1983 legislative priorities 184
1983 statement of policy 186
Charts:
1. The budget dollar: where it goes 173

Harry Pryde, chairman, National Association of Homebuilders Washington, D.C.—Continued
Prepared statement—Continued
Charts—Continued
2. Credit market funds raised: housing shares versus the U.S. Government ... Page 175
3. Distribution of federal sector expenditure ... 177
4. Budget authority for housing and construction ... 178
5. Home mortgage applications accepted for processing ... 181
Harley W. Snyder, president, National Association of Realtors Washington, D.C. ... 192
Worst depression since the 1930's ... 192
Conventional mortgage-backed securities ... 193
Prepared statement ... 194
Introduction ... 194
Housing in recovery ... 195
The short-term outlook for housing ... 195
The importance of controlling Federal deficits ... 195
The long-term outlook for housing ... 196
The importance of mortgage-backed securities ... 196
Mortgage-backed securities: what needs to be done ... 196
Henry Schechter, director, American Federation of Labor/Congress of Industrial Organization, Washington, D.C ... 197
Consumer confidence with increased employment ... 198
Revisions of the tax code ... 199
Prepared statement ... 200
Summary ... 200
Interest rates and housing production ... 202
Market demands for homes ... 204
Multifamily housing construction ... 212
Rental markets and Federal assistance ... 214
Options for increased housing production ... 220

ADDITIONAL MATERIAL RECEIVED FOR THE RECORD

Ryan Homes, Inc., testimony of Malcom M. Prine, chairman of Ryan Homes, Inc ... 225

STATUS OF THE HOUSING SECTOR

MONDAY, FEBRUARY 14, 1983

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10 a.m. in room SD-538 of the Dirksen Senate Office Building; Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Heinz, Gorton, Hawkins, Hecht, Proxmire, and Lautenberg.

OPENING STATEMENT OF CHAIRMAN GARN

The CHAIRMAN. The Banking Committee will come to order. I was a little bit concerned that for the first time since January 1981 when I became chairman that we might start a hearing late. Fortunately, Western Airlines got me here at 3 o'clock this morning, so it's possible to continue starting hearings on time. I am not sure that I will make a great deal of sense, I'm getting too old to stay up that late; nevertheless, we did make it once more.

Over the next several months this committee will face policy decisions having broad implications for the housing sector of our economy. Past history has shown that just as housing generally precedes the rest of the economy out from under adverse elements, so too is it providing a key element of the underlying strength of a recovery.

We have been in a period of what some have described as the worst period of housing since the 1940's, the housing depression which spans almost 2 years, yet the apparent signs of recovery have finally surfaced. Housing starts are up. Sales activity on both new and existing homes have increased. Related industries serving construction have reported an increase in activity. In mortgage finance, FHA applications have reached record levels. Originations of conventional financing have accelerated.

While we all take some amount of satisfaction in reporting these observations, many continue to hold their breath, conscious that if in fact there is a recovery occurring, it may be subject to aberrations, and of course could be retarded or halted altogether if strength does not uniformly return to the economy as a whole.

To say that the housing economy is interest-rate sensitive is to understate the situation. Last summer when this committee considered a housing-stimulus proposal, convincing data was proposed arguing that the demand for housing generally, and especially for newly constructed housing, remains strong, but affordability of financing then lingering at the 16- to 17-percent level prevented

many households from executing plans to change their shelter situation.

The same data showed however, that if interest rates dropped to levels of around 12 percent, pent-up demand would be released for millions of buyers. That is exactly what has happened as first FHA rates dropped to 12 percent and then conventional mortgage rates dropped to the 13-percent level.

I want to warn, though, that this threshold is a very sensitive one. Slight movements in either direction will add significant impact on buyer decisions. On the whole, I believe there is a recovery occurring in the housing sector. We have seen heartening indicators that improvements are underway in other sectors.

Because of this committee's responsibility and commitment to the housing sector, I called this hearing early in the legislative session to attempt to collect evidence on and make judgments about the sustainability of the housing recovery. Our witnesses are most of the key players in the housing economy and are clearly persons who have their fingers directly on the pulse of the patient. We look forward to hearing their testimony today.

I can't emphasize enough the point I made about the sensitivity to the interest rates. A couple of more points down would have an incredible effect on the acceleration of the housing recovery. My comment is that the housing recovery may not be able to continue unless there is improvement in the general economy. I wish to reemphasize my strong feeling about that. I am very leery frankly, going into the 98th Congress, once again worried about Congress' courage to do something about it.

I have been here 8 years: There has been a lot of talk about getting the economy under control by both Presidents and Congresses, and that's all it's been for 8 years, is talk; no courage, no willingness to face up to the problems. We have had accelerating budget deficits in the 8 years I have been here; in fact, the first year I was here, Gerald Ford sent a budget request to the Congress of about $295 billion. We passed about 318. Just during one term in 2 years, I have watched the budget grow and surpass $300, $400, $500, $600, $700, $800 billion, the national debt more than doubled during that period of time—the interest on the national debt in excess of what was necessary for John Kennedy in 1962 to run the entire country and defend it.

So we are still hearing a great deal of rhetoric, we have a Social Security Commission that once again has recommended a short-term fix, and that's all it is, because in 1977 I sat on the floor of the Senate when the last big tax increase was passed and heard people say on the floor— and it is still in the record—that that was a fix that would last for 75 years.

Well, even by Congress' standards of being wrong in their predictions, to miss by 70 years out of 75 is rather gross. So, if any of you think that we have done anything significant with the compromise that must be passed in order to keep the system solvent, we certainly haven't been willing to address any long-term structural changes in social security, other entitlement programs, or the basic problem of the general budget.

And so that's why I'm pleased with what has happened the last few months in the housing market, and I certainly hope it contin-

ues. Unless Congress starts getting its act together and stops the rhetoric in both parties, starts looking at the arithmetic and forgetting who are Republicans and who are Democrats and looking for people to blame, I'm not convinced that we can sustain a housing recovery very long.

The budget is out of control, there isn't enough money in the whole military budget, if we want to go that direction, to solve it. The problem is in these automatically indexed entitlement programs. If Congress wants this recovery to continue, led by the housing industry, they'd better start showing some courage and a lot less political rhetoric in the 98th Congress.

Mr. Secretary, we are very happy to have you as the lead-off witness this morning, and we would be happy to hear your testimony at this time.

But, excuse me, before we continue, we have a statement from Senator Hawkins which we will insert in the record at this point as though read.

[Statement follows:]

STATEMENT OF SENATOR HAWKINS

Mrs. HAWKINS. I commend the chairman of the Senate Banking Committee, Senator Garn, for holding these important oversight hearings on the housing industry. The housing industry is in the midst of a recovery due in large part to the drop in short- and long-term interest rates. The industry has every reason to be optimistic. Housing starts in January increased by 36 percent to an annual rate of 1.7 million which is 95 percent higher than a year earlier. Building permits increase 16 percent between December and January. FHA loan applications have been up for the past 3 months. The December sales of single-family homes improved by 13.8 percent over the preceding month. The inventory of unsold newly constructed homes was down to 5.8 months in December which is very encouraging compared to the 12-month inventory of unsold homes in the fall of 1981. In December, GNMA had its highest monthly volume in history, guaranteeing $2.3 billion in mortgage-backed securities. These indicators show a recovery from a recession which has spanned almost 2 years. This is indeed good news.

Congress must do its best to continue this recovery by addressing important housing issues. These include: Determining whether or not to extend the mortgage revenue bond program and to provide mortgage foreclosure assistance. We must also evaluate existing HUD and FHA; programs, and be receptive to the needs of the primary and secondary markets to ensure a reliable flow of funds for housing. As we evaluate the housing industry and the housing programs I believe we should keep two objectives in mind. First, we must provide safe, decent housing for the needy. Second, we must insure affordable housing and the availability of mortgage credit for those who wish to own their own homes.

STATEMENT OF HON. SAMUEL R. PIERCE, JR., SECRETARY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Secretary PIERCE. Thank you very much, Mr. Chairman, I would like to submit a detailed statement for the record and make some remarks based on that statement.

[The complete statement follows:)

STATEMENT OF SAMUEL R. PIERCE, SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. Chairman, my testimony today will provide information and data on the current condition of the housing industry, and will report on the policies and actions of the Department Housing and Urban Development as they relate to that industry.

On March 8 I will be addressing other programs and legislative initiatives affecting low-income Americans, the general public and the housing industry as a whole. Today, my testimony will primarily address the new construction, sales and mortgage financing aspects of the housing industry.

It is a pleasure to come here today and report to you that all indicators tell us the housing industry is back on course and headed for full recovery. As fel: Beck, First Vice President of the Mortgage Bankers Association, said recently, 1983 is expected to be "boom and zoom, compared to gloom and doom one year ago." The New York Times recognized the new optimism about housing by noting in the February 6 edition that housing is one of the brightest spots on the economic horizon.

ECONOMIC TRENDS

While predictions about the exact extent of the recovery may vary, the fact is that housing ended 1982 on a strong upsurge, and we expect that surge to continue. With the recovery of the economy as a whole gaining momentum, the housing industry shows every sign of playing its traditional role of leading the Nation into recovery. Numerous housing statistics support our prediction that the Nation is on its way to full economic recovery:

Building permits have surged, with December permits up 63.3 percent over December of 1981, to an annualized level of 1.29 million.

In the same period, housing starts gained 38.5 percent, reaching an annual rate of 1.22 million units.

The ratio of FHA new construction applications to those for existing home sales is climbing. Actual new construction applications amounted to 11,307 in December, a little more than 13 percent of the total; in January, the 12,189 new construction applications accounted for more than 16 percent of all those received. Considering that FHA accounts for approximately 10 to 12 percent of the market for new residential starts, this indicates vast improvement. December sales of new single-family homes improved by 13.8 percent over the preceding month.

Construction contracts awarded in December rose to $13.98 billion, the highest amount in 3 years, reflecting the continued strengthening of the housing industry as well as other construction. Actual construction spending in December was 1.4 percent greater than November, and November was up 3.1 percent over October, to an annualized level of $239 billion.

Inventory of unsold newly-constructed homes was down to a 5.4 months supply in November, the lowest figure in 1982, and a 5.8 months supply in December. These statistics are particularly welcome when we recognize that in the fall of 1981, there was a 12-month inventory of unsold homes.

The Housing and Urban Affairs Daily of February 4, 1983, reports that lumber production rose 8.7 percent in November with hardwood production leading with an increase of 14.2 percent from October to November. The rate of lumber shipments was up 5.7 percent to 30.5 billion board feet.

The drop in unemployment to 10.4 percent announced last month is only the first stage in an improving employment situation. We are well aware of the high unemployment rate in the construction industry, and one of the most heartening aspects of the upsurge in housing activity is its effect on reducing that industry's unemployment . . . as well as the unemployment rate for a host of related industries and businesses.

As construction picks up, so do all of those industries that manufacture or supply the 3,000 distinct products that go into every new housing unit: building products, carpeting, appliances, furniture and accessories.

Construction workers are going back to work, and more job opportunities are opening up every day as construction activity accelerates. Construction industry employment was up from 3.812 million in December to 3.927 million in January. The unemployment rate was down from 22.0 percent in December to 20.0 percent in January. For every 100,000 housing starts, 142,000 jobs are created—about 80,000 in construction trades and 60,000 in related industries; therefore, an increase of 400,000 starts in 1983 can be projected to stimulate employment for 568,000 people and decreases unemployment significantly.

FHA applications in the last three months of 1982 broke all records in the 48-year history of the program, with December's volume reflecting an annualized rate of over 1.3 million units insured. December registered the historic high for FHA single-family applications, topping November's unprecedented level with a 10 percent increase. Actual applications in December were 82,558, an annual rate of 1,312,600. This volume was recorded in spite of the holiday period and the fact that two of the largest volume offices were closed for at least a day because of blizzards. January's rate fell slightly, but the volume nevertheless was 74,034, an annual rate of 1,053,800, the highest number of actual applications ever recorded in January.

While some of the applications for existing housing do represent refinancing situations, even these help to speed economic recovery. Refinancing enables families to reduce their monthly shelter costs and increases their disposable income available for purchases in the marketplace. At the same time refinancing reduces the actuarial risk to FHA. Now, however, we have strong indications that the ratio of refinancings has dropped to about 10 to 12 percent.

As the volume of FHA applications began to swell, the Administration requested, and the Congress moved quickly to raise the FHA credit limit by $6.1 billion for this Fiscal Year, bringing the limit up to $45.9 billion. I particularly want to thank Senator Garn for expediting that important effort.

In December, GNMA experienced the highest monthly volume in its history, guaranteeing $2.3 billion in mortgage-backed securities. Last week alone, GNMA guaranteed $1.3 billion—the highest weekly volume ever. Recognizing that GNMA activity occurs after FHA-insured mortgages are originated, we expect the volume of GNMA mortgage-backed securities to exceed $3 billion in February.

Mortgage interest rates have declined substantially, with FHA rates now at 12 percent from a high of 17.5 percent over a year ago.

Interest rates for conventional mortgages are at their lowest level since September and October of 1980, with average rates for 30-year conventional mortgages at 13.06 percent in the first week in February.

With this easing of interest rates, housing has become affordable for a significantly increased number of households. Every one-half percentage point drop in rates brings about 800,000 more families into the market. With rates hovering around 17 percent, fewer that 5 million families could qualify for a 30-year, $60,000 loan. Over 10.5 million families are now eligible for the same mortgage with a 12 percent rate—more than doubling the number of families which can qualify. On a $60,000 mortgage, the difference between 1981's 17.5 percent and today's 12 percent FHA rate amounts to a savings of $94,620 over a 30-year term, or $262.63 a month. Actual monthly payments are reduced from $879.80 to $617.17. This represents a 30 percent savings in a homebuyer's monthly mortgage payment.

One of the most important changes in 1982 for housing was the passage of Senator Garn's financial institutions legislation. The impact of this legislation has been to bring money back from large money market funds to local depository institutions. Over $200 billion has been placed on deposit with local institutions since their Money Market accounts were introduced on December 14, 1982. Of this amount, 30 percent (or $60 billion), represents totally new deposits. These deposits will increase the funds available to finance new homes. Many of these funds have been used to purchase conventional, FNMA, FHLMC and GNMA mortgage-backed securities. With regard to GNMA, these investments have contributed to the reductions of the spread on effective interest rates for GNMA's, compared to ten-year Treasury bonds, from 21 basis points on December 21, 1982, to 75 basis points on February 9, 1983. This phenomenon results in almost a one-half percentage point reduction in the effective yield on FHA-insured loans.

Other economic trends also support this optimistic outlook on the economy. We ended 1982 with an annual CPI inflation rate of 3.9 percent. The prime interest rate of major banks is 11 percent, compared to 20.5 percent in September 1981. In December, the Federal Reserve discount rate was lowered to 8.5 percent, down from 12 percent in mid-July 1982. The government's index of leading economic indicators rose 1.8 percent in December, the largest increase in the last two years and the eighth increase in the last nine months. December's rise was more broadly based

than the previous months' gains, reinforcing indications that economic recovery is underway.

The Administration is projecting 3.1 percent growth in Gross National Product from the fourth quarter of 1982 to the same period this year, with four percent growth in GNP estimated over the next four years. That very conservative projection would mean one million new jobs created by July of this year, and fifteen million by 1988. Leading analysts, from Alice Rivlin to Alan Greenspan, who all agree that the economy is recovering also agree that these estimates of GNP growth are indeed conservative. In fact, on February 4 Alan Sinai of Data Resources predicted that an annual growth rate of 3 to 4 percent after inflation was possible this quarter, and 45 forecasters polled monthly by Blue Chip Economic Forecasters have made a similar estimate for the quarter.

Thus, as we move further into the first quarter of 1983, we find both the housing industry and the economy as a whole in a period of transition clearly heading toward full recovery. Already, we have achieved markedly lower inflation resulting in reduced interest rates. Now we are witnessing resurgent housing demand.

FHA ACTIVITY

The economic indicators just mentioned demonstrate that the President's Economic Recovery Program is, in fact, working. With the decline in interest rates, we have recognized tremendous increases in mortgage activity.

Although FHA normally accounts for 10 to 12 percent of the mortgage market, FHA has been in the forefront in spurring recovery of the housing economy. Recent statistics show that 26 percent of the mortgage originations, not including refinancing actions, have occurred with FHA insurance. This has taken place not only because of lower interest rates, but also because FHA actions have proved responsive to consumer needs. During this difficult time for the housing sector of our economy, the Department focused its efforts on making the best use of available resources and existing programs in the following ways:

We set new, liberalized guidelines to determine income qualifications for FHA buyers, thereby increasing the number of families which could qualify during a period of high interest rates.

We permitted builders to "buydown" the interest rate on level payment and particularly Graduated Payment Mortgages (GPMs), a combination that allowed many new potential homebuyers to qualify for mortgages.

We made FHA insurance available for high loan-to-value ratio mortgages in Shared Equity Mortgage arrangements and also began insuring Growing Equity Mortgages, another alternative mortgage instrument designed to attract lower mortgage rates.

GNMA extended the Mortgage-Backed Securities program to include buydowns on GPMs, SEMs and GEMs in mortgage pools, making possible essential secondary market financing.

FHA has also taken several actions to specifically assist new construction activity. Our recent instructions to the field which permit establishment of different fee schedules for appraisals should help FHA better serve the new construction sector of the housing industry. We will soon revise the house/lot match-up and "fast-start" procedures for proposed construction to further improve service. We are also enhancing the use of master conditional commitments for new subdivisions. I will discuss in more detail later our Joint Venture for Affordable Housing and the specific legislative initiatives which should also help spur activity in the new housing market.

While some of the applications for existing housing do represent refinancing situations, these also help to speed economic recovery by enabling families to reduce their monthly shelter costs and increase their disposable income available for purchases in the marketplace and at the same time improve the actuarial risk to FHA. Now, however, we have strong indications that the ratio of refinancing applications is dropping. An informal survey of field offices last month suggests that refinancing cases account for 15 to 20 percent of our caseload now, down from about 30 percent in November and December. All signs point to continued high FHA volume for the next few months, continuing the steady gains that began last August when the FHA rate started declining.

We have worked hard and long at HUD to make FHA function better, and the unprecedented volume of buisness that has poured into our field offices proved an excellent test of our determination to be responsive to our users. A number of new procedures were quickly put into place to streamline processing to reduce backlogs and make better use of our staff time, including:

Detaling HUD personnel to single-family processing;

Expanding the use of fee personnel for appraisals, mortgage credit and architectural reviews;

Shifting work from busy HUD offices to those with less activity;

Utilizing increased staff years for overtime and temporary employment, with particular emphasis on hiring students from historically black colleges;

Certifying additional closing clerks to process backlogs;

Simplifying the process for refinancing transactions with occupant mortgagors;

Permitting mortgagee determinations of maximum mortgage amounts when processing Veterans Administration Certificates of Reasonable Value (CRVs);

Streamlining data requirements for field office processing;

Encouraging lenders to fill out mortgage credit worksheets in order to save processing time in exchange for priority treatment;

Liberalizing fee structures to allow flexibilty in setting fees; and

Establishing procedures to give field offices easier access to funds for paying fee personnel.

These measures have been a success. I have directed headquarters staff to monitor the processing backlog in the field offices every two weeks in order to evaluate the effectiveness. Preliminary reports from the last two weeks of January indicate that fewer than five offices now have substantial backlogs. This is a tribute not only to the initiatives we have begun, but also to the ingenuity and dedication of HUD's field office personnel. Clearly, we have a responsibility to process applications as quickly as possible, recognizing that homebuyers have postponed purchases, awaiting favorable interest rates to make their purchases feasible.

HOUSING CREDIT

Now that the housing industry is leading the economy into a recovery, we anticipate a growing market for housing that will continue to build through the eighties. To meet that demand, we have to be concerned about two things: the availability of mortgage credit and the affordability of housing.

With regard to mortgage credit, in an effort to increase the availability of mortgage funds, I am working closely with the Secretaries of Treasury and Labor to modify their regulations covering mortgage revenue bonds and private pension funds.

Legislation has been passed affecting the financing of single-family homes through tax-exempt mortgage revenue bonds, but regulations prepared by the Treasury Department were widely viewed as unworkable. We worked directly with Treasury to overcome the technical deficiencies of those proposed regulations which, as a result, helped to make the bonds marketable and available as an additional source of mortgage financing.

Pension funds may well be the single most important source of mortgage funds in the near future. Pension fund assets currently exceed $700 billion, yet studies last year indicated that investment by these funds in mortgages or mortgage-backed securities amounted to only about three percent of their total portfolios. In addressing that problem, we worked closely with the Labor Department to begin relaxing its ERISA regulations which limit pension funds investment in residential mortgages, and we will continue to work with that Department on further removal of constraints imposed on mortgage investments.

Another factor that in the past has affected this situation was a general lack of awareness on the part of pension fund officials that mortgage instruments are competitive in the investment market. To begin correcting that situation, last year I convened conferences with the chief financial officers of the Nation's top pension funds and embarked on a program to spread the word about the desirability of adding mortgage investments to pension fund portfolios.

We are determined to do our part to ensure that financing is available as the construction industry accelerates its pace in the months ahead. The Aministration is considering "Trusts for Investments in Mortgages" (TIMs), a package of incentives to spur private sector investments in housing. In line with that, I welcomed the recent announement of Residential Funding Corporation's plans for a mortgage-backed securities issue pooling a wide range of conventional loans.

The construction industry itself is contributing to this effort. The National Association of Home Builders recently introduced HOMAC to the secondary market. HOMAC stands for the Home Mortgage Access Corporation, which acts as a conduit which pools builder demand for mortgage money and arranges for master commitments from the secondary market. I understand HOMAC also negotiates with sec-

ondary market institutions for the development of mortgage loans designed to fit the needs of the market.

We are pleased to have the private sector, with its greater flexibility, increasing its participation in the secondary market. I look forward to continuing to work with those leaders in the field who will be discussing these issues in more detail today.

HOUSING AFFORDABILITY

Turning to the second area of prime concern, housing affordablity, our studies show that this is the major housing problem facing American families today.

At HUD, we've developed the Joint Venture for Affordable Housing to bring costs more in line with the budget of the American family. This is a prime example of how public/private partnerships can work to the benefit of an entire community, as well as an individual or family. The Joint Venture is based on cooperation among all levels of government, as well as various national organizations, builders, and others in the community. Through the Joint Venture, we're proving that housing costs can be reduced when builders and developers cooperate with State and local governments to reduce unnecessary regulations, streamline processing, and encourage the kinds of housing needed for today's smaller and more diverse households.

We're already documenting actual savings . . . as much as 20 percent . . . from specific cost-reduction techniques. These documented savings are coming in from sites in some of the 23 cities that are participating in the Affordable Housing Demonstration project which is part of the joint venture. For example, in Lincoln, Nebraska, the first home in the demonstration was sold for $10,000 less than the cost of comparable houses in the area that were priced at around $50,000. Another example is Grand Junction, Colorado, where 17 homes have been sold in the $39,000 to $47,000 price range, roughly $5,000 under the lenders' appraisals. Elkhart County, Indiana is developing a project mixing manufactured, modular and stick-built housing to provide data on both cost savings and marketability of the manufactured/modular approach. Last month, the Phoenix, Arizona project held a grand opening with homes priced as much as $11,000 below identical houses the builder is selling in other parts of the city. Over 90 homes were quickly sold as word spread about the well-designed, below market-cost houses.

Savings from these cost-cutting measures, combined with the benefits of recent interest rate decreases, produce a truly significant difference for the prospective homebuyer.

To demonstrate this more explicitly, if a family which had received the $10,000 savings on the $50,000 home in the Joint Venture Demonstration combined this reduction with the recent interest savings, their home could be purchased for approximately $105,920 less over the 30-year life of their loan. This translates into a monthly savings of $322 or a 44 percent reduction in their monthly mortgage payment.

Rehabilitation and conversion activities will also play a part—an increasingly important part—in meeting the need for affordable housing. Projects of this type will be another element in the growth of the housing industry over this decade.

We are delivering on President Reagan's commitment to allow opportunities for the free enterprise system to work by helping the housing industry—without subsidy—to deliver an affordable product at a time when lower interest rates are bringing more families back into the market.

REDIRECTION OF FHA

Over the past two years, the Department has charted significant new directions in keeping with the Administration's goals for the Nation as a whole. We have focused on ways to improve the efficiency and effectiveness of our programs and to use the available dollars to serve the largest possible number of people in need of housing assistance. At the same time, we take seriously our charge, in the Housing and Urban Development Act, to "encourage the maximum contributions that may be made by vigorous private homebuilding and mortgage lending industries to housing, urban development, and the national economy." To achieve that goal, we have embarked on a program to improve our procedures, eliminate unnecessary regulations and support, not hinder, the efficient functioning of this important part of the private sector.

The redirection of FHA is a case in point. Rather than competing with private mortgage insurers, FHA is returning to its role as insurer for the underserved by focusing on serving first-time homebuyers and insuring inner-city and rural properties.

I have identified our 203(k) single-family program with its provision for including rehabilitation costs in the insured mortgage as a vehicle for serving the inner-cities.

This Spring the Department will launch an intensive effort to promote the use of this program in 15 cities. GNMA has established a secondary market for the 203 program which has already increased activity on this front.

In our direct endorsement program we will initiate special outreach effort in rural areas, enlisting the assistance of the Farmers Home Administration county agents and bringing small town bankers into originating FHA mortgages by allowing them to utilize their standard operating practices and personnel.

I am looking at ways to increase the participation of first-time homebuyers in our FHA programs. One way to achieve this would be to increase maximum loan-to-value ratios for purchasers of modestly-priced homes, thereby reducing their down payment requirement. This will be among the legislative proposals I will present to this committee later this month. I am continuing to study ways in which we can make FHA more responsive to these special needs.

Instead of acting as the housing industry's regulator, FHA is setting a new example in deregulation. We believe that it is no longer necessary—indeed, it is costly and counterproductive—to superimpose Federal standards over local standards, and so we are initiating several changes in an effort toward deregulation.

We are revising our Minimum Property Standards to eliminate unnecessary requirements on marketability and livability and to defer to local standards for model codes for health and safety requirements.

We have eliminated subdivision and environmental reviews where a local jurisdiction has been approved for local Area Certifications; approximately 150 localities nationwide have qualified so far.

We have raised the threshold for requiring Environmental Impact Statements from 500 unit developments to 2,500 unit developments and will accept the VA EIS.

We are making progress toward privatizing FHA processing through our Direct Endorsement and Coinsurance programs. By the end of this month, we hope to have published the final rule for single-family direct endorsement procedures, with training beginning immediately leading to a target date of April to have the program operational.

The first three mortgage companies have been approved to handle multifamily coinsurance loans under the 223(f) program. In a new interim rule, we will facilitate state housing agencies as multifamily loan originators. Already our 223(f) initiatives, which have allowed GNMA to provide secondary market access, have increased activity in this existing multifamily rental housing refinancing and rehabilitation program.

Regulations for delegated processing with coinsurance in the 221(d)(4) new multifamily rental housing program are under development and we expect to implement it later this year.

We are in the process of organizing an Advisory Council to review all HUD construction documents to make them more sensible and functional.

We have initiated, on a demonstration basis in four states, the "lender option" which permits lenders to choose the most convenient FHA office at which to process their applications.

All of these efforts are part of our essential role in the current housing recovery, a role that will help to ensure that the momentum is sustained.

CONCLUSION

As we look to the year ahead, we share the view of leading analysts in the field that home sales will rise. The National Association of Home Builders is forecasting a 30 percent improvement in sales. They predict 1.4 to 1.5 million housing starts in 1983 with resales in the range of 2.5 million. Certainly, historical relationships between FHA application rates and sales of new and existing homes would bear out that assessment.

Multifamily construction is also expected to rise in the coming months, as gains in median rents make rental apartments more attractive investments. Some analysts predict that construction of rental apartments will claim a larger share of the market than usual in the 1980s. Our 1984 legislative initiatives for Multifamily Graduated Payment Mortgages and Shared Appreciation Mortgages allow FHA to augment the private sector response to rental housing demand.

Some analysts are predicting further declines in interest rates over the next few months. At the NAHB convention last month, a panel of national home-loan experts predicted lower mortgages rates later this year. Whether or not rates continue to drop, we see little probability of strong upward pressure in 1983. The outlook is at least for stability in rates at levels that we know can make housing affordable for

hundreds of thousands—indeed millions—more families which were squeezed out of the market by the inflation of the late seventies.

We know that throughout the 1980s the demand for housing will be increasing. Forty-one million Americans—ten million more than in the 1970s—will turn 30 during this decade, putting them into the peak period for buying a first home. Within the next five years, population experts tell us that nine million new households will enter the housing market. The housing industry is on the threshold of a period that promises to be one of the most challenging and most rewarding, that it has experienced.

We at the Department of Housing and Urban Development are prepared to do our part to support and enhance the growth that lies ahead. The Administration, by providing the essential foundation of a healthy economy free from unnecessary restraints on growth and production, has created the climate in which the housing industry can flourish. I am confident of continued movement toward recovery for both housing and the economy as a whole, with the housing industry once again leading that recovery. Recovery, this time, will be firmly based on a healthy stable economy that can sustain a housing industry growing to meet the demands of a changing population.

Secretary PIERCE. Mr. Chairman, my testimony today will provide information and data on the current condition of the housing industry and will report on the policies and actions of the Department of Housing and Urban Development, as they relate to that industry.

On March 8 I will be addressing other programs and legislative initiatives affecting low-income Americans, the general public, and the housing industry as a whole. Today my testimony will primarily address the new construction sales and mortgage financing aspects of the housing industry.

HEADING FOR FULL RECOVERY

It is a pleasure to come here today and report to you that all indicators tell us the housing industry is back on course and headed for full recovery. As Felix Beck, first vice president of the Mortgage Bankers Association said recently, 1983 is expected to be "boom and zoom compared to gloom and doom 1 year ago."

The New York Times recognized the new optimism about housing by noting in the February 6 edition that housing is one of the brightest spots on the economic horizon.

While predictions about the exact extent of the recovery may vary, the fact is that housing ended 1982 on a strong upsurge, and we expect that surge to continue. With the recovery of the economy as a whole gaining momentum, the housing industry shows every sign of playing its traditional role of leading the Nation into recovery. Numerous housing statistics support our prediction that the Nation is on its way to full economic recovery and housing will lead that recovery.

Building permits have surged, with December permits up 63.3 percent over December 1981, to an annualized level of 1.29 million. In the same period, housing starts gained 38.5 percent, reaching an annual rate of 1.22 million units.

The ratio of FHA new construction applications to those for existing home sales is climbing. Actual new construction applications amounted to 11,307 in December, a little more than 13 percent of the total; in January, the 12,189 new construction applications accounted for more than 16 percent of all those received. Considering that FHA accounts for approximately 10 to 12 percent of the

market for new residential starts, this indicates vast improvement. December sales of new single-family homes improved by 13.8 percent over the preceding month.

Construction contracts awarded in December rose to $13.98 billion, the highest amount in 3 years, reflecting the continued strengthening of the housing industry as well as other construction. Actual construction spending in December was 1.4 percent greater than November, and November was up 3.1 percent over October, to an annualized level of $239 billion.

Inventory of unsold newly constructed homes was down to a 5.4 months' supply in November, the lowest figure in 1982, and a 5.8 months' supply in December. These statistics are particularly welcome when we recognize that in the fall of 1981 there was a 12-month inventory of unsold homes.

The Housing and Urban Affairs Daily of February 4, 1983, reports that lumber production rose 8.7 percent in November with hardwood production leading with an increase of 14.2 percent from October to November. The rate of lumber shipments was up 5.7 percent to 30.5 billion board feet.

The drop in unemployment to 10.4 percent announced last month is only the first stage in an improving employment situation. We are well aware of the high unemployment rate in the construction industry, and one of the most heartening aspects of the upsurge in housing activity is its effect on reducing that industry's unemployment, as well as the unemployment rate for a host of related industries and businesses.

As construction picks up, so do all of those industries that manufacture or supply the 3,000 distinct products that go into every new housing unit: building products, carpeting, appliances, furniture, and accessories.

Construction workers are going back to work, and more job opportunities are opening up every day as construction activity accelerates. Construction industry employment was up from 3.812 million in December to 3.927 million in January. The unemployment rate was down from 22 percent in December to 20 percent in January. For every 100,000 housing starts, 142,000 jobs are created—about 80,000 in construction trades and 60,000 in related industries; therefore, an increase of 400,000 starts in 1983 can be projected to stimulate employment for 568,000 people and decreases unemployment significantly.

FHA APPLICATIONS BREAK RECORD

FHA applications in the last 3 months of 1982 broke all records in the 48-year history of the program, with December's volume reflecting an annualized rate of over 1.3 million units insured. December registered the historic high for FHA-single family applications, topping November's unprecedented level with a 10-percent increase. Actual applications in December were 82,558, an annual rate of 1,312,600. January's rate fell slightly, but the volume nevertheless was 74,034, an annual rate of 1,053,800, the highest number of actual applications ever recorded in January.

While some of the applications for existing housing do represent refinancing situations, even these help to speed economic recovery.

Refinancing enables families to reduce their monthly shelter costs and increase their disposable income available for purchases in the marketplace. At the same time, refinancing reduces the actuarial risk to FHA. Now, however, we have strong indications that the ratio of refinancings has dropped to about 10 to 12 percent.

As the volume of FHA applications began to swell, the administration requested, and the Congress moved quickly to raise the FHA credit limit by $6.1 billion for this fiscal year, bringing the limit up to $45.9 billion. I, particularly, want to thank you, Senator Garn, for expediting that important effort.

In December, GNMA experienced one of the highest monthly volume in its history, guaranteeing $2.3 billion in mortgage-backed securities. Last week alone GNMA guaranteed $1.3 billion—the highest weekly volume ever. Recognizing that GNMA activity occurs after FHA-insured mortgages are originated, we expect the volume of GNMA mortgage-backed securities to exceed $3 billion in February.

Mortgage interest rates have declined substantially, with FHA rates now at 12 percent from a high of 17.5 percent about 1 year ago. Interest rates for conventional mortgages are at their lowest level since September and October 1980, with average rates for 30-year conventional mortgages at 13.06 percent in the first week of February.

With this easing of interest rates, housing has become affordable for a greater number of households. Every one-half percentage point drop in rates brings about 800,000 more families into the market. With rates hovering around 17 percent, fewer than 5 million families could qualify for a 30-year, $60,000 loan. Over 10.5 million families are now eligible for the same mortgage with a 12-percent rate—more than doubling the number of families which can qualify. On a $60,000 mortgage, the difference between 1981's 17.5 percent and today's 12-percent FHA rate amounts to a savings of $94,620 over a 30-year term, or $262.63 a month. Actual monthly payments are reduced from $879.80 to $617.7. This represents a 30-percent savings in a homebuyer's monthly mortgage payments.

One of the most important changes in 1982 for housing was the passage of Senator Garn's financial institutions legislation. The impact of this legislation has been to bring money back from large money market funds to local depository institutions.

Over $200 billion has been placed on deposit with local institutions since their money market accounts were introduced on December 14, 1982. Of this amount, 30 percent—or $60 billion—represents totally new deposits. These deposits will increase the funds available to finance new homes.

Many of these funds have been used to purchase conventional, FNMA, FHLMC, and GNMA mortgage-backed securities. With regard to GNMA, these investments have contributed to the reductions of the spread on effective interest rates for GNMA's, compared to 10-year Treasury bonds, from 121 basis points on December 21, 1982, to 75 basis points on February 9, 1983.

This phenomenon results in almost a one-half percentage point reduction in the effective yield on FHA-insured loans.

Other economic trends also support this optimistic outlook on the economy. We ended 1982 with an annual Consumer Price Index in-

flation rate of 3.9 percent. The prime interest rate of major banks is 11 percent, compared to 20.5 percent in September 1981.

In December, the Federal Reserve discount rate was lowered to 8.5 percent, down from 12 percent in mid-July 1982. The Government's index of leading economic indicators rose 1.8 percent in December, the largest increase in the last 2 years and the eighth increase in the last 9 months.

December's rise was more broadly based than the previous months' gains, reinforcing indications that economic recovery is underway.

Thus, as we move forward into the first quarter of 1983 we find both the housing industry and the economy as a whole in a period of transition, clearly heading toward full recovery.

Already we have achieved markedly lower inflation, resulting in reduced interest rates. Now we are witnessing resurgent housing demand.

The economic indicators just mentioned demonstrate that the President's economic recovery program is, in fact, working. With the decline in interest rates, we have recognized tremendous increases in mortgage activity.

Although FHA normally accounts for 10 to 12 percent of the mortgage market, FHA has been in the forefront in spurring recovery of the housing economy. Recent statistics show that 26 percent of the mortgage originations, not including refinancing actions, have occurred with FHA insurance. This has taken place not only because of lower interest rates, but also because FHA actions have proved responsive to consumer needs.

For example, we set new, liberalized guidelines to determine income qualifications for FHA buyers, thereby increasing the number of families which could qualify during a period of high interest rates.

We made FHA insurance available for high loan-to-value ratio mortgages in shared equity mortgage arrangements and also began insuring growing equity mortgages, another alternative mortgage instrument designed to attract lower mortgage rates.

Now that the housing industry is leading the economy into a recovery we anticipate a growing market for housing that will continue to build through the 1980's. To meet that demand we have to be concerned about two things, the availability of mortgage credit and the affordability of housing.

With regard to mortgage credit, in an effort to increase the availability of mortgage funds, I am working closely with the Secretaries of Treasury and Labor to modify their regulations, covering mortgage revenue bonds and private pension funds.

Legislation had been passed affecting the financing of single-family homes through tax-exempt mortgage revenue bonds, but regulations prepared by the Treasury Department were widely viewed as unworkable.

We worked directly with Treasury to overcome the technical deficiencies of those proposed regulations which, as a result, helped to make the bonds marketable and available as an additional source of mortgage financing.

USING PENSION FUND ASSETS

Pension funds may well be the single most important source of mortgage funds in the near future. Pension fund assets currently exceed $700 billion, yet studies last year indicated that investment by these funds and mortgages or mortgage-backed securities amounted to only about 3 percent of their total portfolios.

In addressing that barrier to investments, we worked closely with the Labor Department to begin relaxing its ERISA regulations which limit pension funds investment in residential mortgages, and we will continue to work with that Department on further removal of constraints imposed on mortgage investments.

Another factor that in the past has affected this situation was a general lack of awareness on the part of pension fund officials that mortgage instruments are competitive in the marketplace.

To begin correcting that situation, last year I convened conferences with the chief financial officers of the Nation's top pension funds and embarked on a program to spread the word about the desirability of adding mortgage investments to pension fund portfolios.

We are determined to do our part to insure that financing is available as the construction industry accelerates its pace in the months ahead. The administration is considering "Trusts for Investments in Mortgages" (TIM's), a package of incentives to spur private sector investments in housing.

In line with that, I welcomed the recent announcement of Residential Funding Corp.'s plans for a mortgage-backed securities issue pooling a wide range of conventional loans.

The construction industry itself is contributing to this effort. The National Association of Home Builders recently introduced HOMAC to the secondary market. HOMAC stands for the Home Mortgage Access Corp., which acts as a conduit which pools builder demand for mortgage money and arranges for master commitments from the secondary market. I understand HOMAC also negotiates with secondary market institutions for the development of mortgage loans designed to fit the needs of the market.

We are pleased to have the private sector, with its greater flexibility, increasing its participation in the secondary market. I look forward to continuing to work with those leaders in the field who will be discussing these issues in more detail today.

REDUCING HOUSING COSTS

Turning to the second area of primary concern, housing affordability, our studies show that this is the major housing problem facing American families today.

At HUD we have developed the joint venture for affordable housing to bring costs more in line with the budget of the American family. This is a prime example of how public/private partnerships can work for the benefit of an entire community as well as an individual or family.

The joint venture is based on cooperation among all levels of government, as well as various national organizations, builders, and others in the community. Through the joint venture we are proving that housing costs can be reduced when builders and developers co-

operate with State and local governments to reduce unnecessary regulation, streamline processing, and encourage the kinds of housing needed for today's smaller and more diverse households.

We are already documenting actual savings, as much as 20 percent, from specific cost reduction techniques. These documented savings are coming in from sites in some of the 23 cities that are participating in the affordable housing demonstration project which is part of the joint venture.

For example, in Lincoln, Nebr., the first home in the demonstration was sold for $10,000 less than the cost of comparable houses in the area that were priced at around $50,000.

Savings from these cost-cutting measures, combined with the benefits of recent interest rate decreases, produce a truly significant difference for the prospective home buyer.

To demonstrate this more explicitly, if a family which had received the $10,000 savings on the $50,000 home in the joint venture demonstration combined this reduction with the recent interest savings, their home could be purchased for approximately $105,920 less over the 30-year life of their loan. This translates into a monthly savings of $322, or a 44-percent reduction in their monthly mortgage payment.

We are delivering on President Reagan's commitment to allow opportunities for the free enterprise system to work by helping the housing industry, without subsidy, to deliver an affordable product at a time when lower interest rates are bringing more families back into the market.

Over the past 2 years, the Department has charted significant new directions in keeping with the administration's goals for the Nation as a whole. We have focused on ways to improve the efficiency and effectiveness of our programs and to use the available dollars to serve the largest number of people in need of housing assistance. At the same time we take seriously our charge in the Housing and Urban Development Act to encourage the maximum contributions that can be made by vigorous private homebuilding and mortgage-lending industries to housing, urban development, and the national economy. To achieve that goal we have embarked on a program to improve our procedures, eliminate unnecessary regulations, and support, not hinder, the efficient functioning of this important part of the private sector.

The redirection of FHA is a case in point. Rather than competing with private mortgage insurers, FHA is returning to its role as insurer for the underserved by focusing on serving first-time low-to-moderate-income home buyers and insuring inner city and rural properties.

The housing industry is on a threshold of a period that promises to be one of the most challenging and most rewarding that it has experienced. We of the Department of Housing and Urban Development are prepared to do our part to support and enhance the growth that lies ahead.

The administration, by providing the essential foundation of a healthy economy, free from unnecessary restraints on growth and production, has created a climate in which the housing industry can flourish.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Secretary.

Mr. Secretary, the most direct influence in your Department on the housing market is through FHA mortgage insurance which has supported a significant portion of housing financing in the past 2 years. As you say, FHA insurance applications have skyrocketed recently to 1.85 million annual rate from about 300,000 in 1982.

From a mechanical standpoint, what steps have you taken to handle this volume? I'm glad it is there, but it's such a significant increase, are you able to handle the applications and process them?

Secretary PIERCE. Yes, we are. It's a nice problem to deal with, a much healthier problem, but we are doing very well with it. We have taken on temporary personnel. We are using key personnel more. We are shifting loads from offices that are very busy to those that are not very busy. We have also talked with representatives of various organizations, such as the National Association of Home Builders, the Mortgage Bankers Association, to get their thoughts and ideas on how we can do a better job.

We are also in the process of trying to get the private sector to do more of the processing work, and we are moving in that direction very well.

We are doing everything we possibly can to move these applications as fast as we can, and we think we are making progress. The last report we got from the field, indicated that there were only five offices that were really overburdened.

The CHAIRMAN. When do you expect to put into effect the delegated processing regulations that were proposed last fall?

Secretary PIERCE. We expect them to be put into operation very shortly. They are in the final process of being cleared at HUD by our general counsel.

The CHAIRMAN. As you stated, you complimented the committee on raising the FHA commitment ceiling by $6.1 billion just 2 months ago, yet your fiscal year 1984 budget request shows a $4 billion decline from the 1983 level.

What kind of harm do you think will come from that maintaining the 1983 level?

Secretary PIERCE. Actually, according to our people, we expect the FHA level to go down somewhat in the year ahead. It's up right now and will be up until around the spring, when we expect a decline. We think with that decline, the amount that we're asking for will be sufficient. If not, we will report immediately to the Congress and ask for an additional increase.

The CHAIRMAN. So you won't leave a ceiling there to bump against?

Secretary PIERCE. No, we will not.

The CHAIRMAN. GNMA guaranteed mortgage backed securities are also very important to the availability of housing finance.

Do you expect to make any changes to the GNMA program to enhance its role in the secondary market?

Secretary PIERCE. Yes. We are developing a program now to be called GNMA 2, which will have what is known as jumbo pools and will be more streamlined, more computerized, more up-to-date than GNMA 1. That is the change that's being made right now.

The CHAIRMAN. You mentioned in your testimony your efforts to stimulate pension funds getting more involved in mortgage lend-

ing. Some believe that pension funds need protection against loans repaying early, before they're willing to invest in mortgage backed securities.

PENSION FUNDS MORTGAGE INVESTMENT

Is GNMA investigating how it might increase pension funds mortgage investment by structuring mortgage backed securities with protection against that?

Secretary PIERCE. Yes. We're looking at that. We haven't reached any final conclusions, but that is being studied.

The CHAIRMAN. You do feel that it is something that is a problem that needs to be——

Secretary PIERCE. It is a problem. There is no doubt about that. It is a problem. It needs to be addressed, but we haven't got any answers yet.

The CHAIRMAN. For the last couple of years, everybody talks about this vast pool of money out there and that there seems to be constant roadblocks in freeing it up. Everybody talks about it on both sides. I hope we can see some action to remove any stumbling blocks.

Secretary PIERCE. We are moving, we think, in that direction. I think we are making progress and, hopefully, there will be more pension money invested in mortgage backed securities in the near future.

The CHAIRMAN. Exactly what changes have been made in ERISA to free up more pension funds?

Secretary PIERCE. Well, basically, what ERISA did before, was to make it very difficult for pension funds to invest in mortgages for mortgage backed securities. The difficulty was in the complex procedures one had to go through to make such investments. By the time an investor went through all the redtape and did all the things the ERISA regulations required, it didn't pay to invest. It was just too complicated.

So now we are trying to simplify those regulations, so that the pension funds will still be protected, but an investor will not have to go through all of the complicated regulations that he once did. In other words, I think there was a real definite effort on the part of the Department of Labor in the past, to keep pension funds out of mortgages and mortgage backed securites, and it was done by just making regulations that were too complicated to make it worthwhile getting involved in such investments.

We have been trying to try to relax those regulations.

The CHAIRMAN. Well, most of the changes need to be made in the Department of Labor. I understand that. What is HUD doing specifically in your own authority to try to free up the funds.

Secretary PIERCE. The thing we are doing is working cooperatively with the Department of Labor. That is what we are doing, because they have the responsibility, and we have to influence them and try to submit to them better ways of doing this, so that the security of the pension funds will not be harmed, and at the same time, the money can be invested in mortgages and mortgage backed securities in a less complicated manner.

The CHAIRMAN. You will continue to influence——

Secretary PIERCE. We will try. We will keep on going. I think we're making progress. Sometimes we have disagreements, and sometimes we have to have some Cabinet Councils look at certain things, but on the whole, I think we're making very good progress.

The CHAIRMAN. Could we talk about pressure rather than influence; there must be pushing, shoving. Does the Department of Labor understand through these high unemployment rates that there are a lot of jobs in the housing industry that can be made available, if they would get off their duffs and move faster on changing some of these regulations?

Secretary PIERCE. Well, they do, and I must congratulate Secretary Donovan, because he has been cooperating. But as I find in government, when you get into the technical details and you get into the bureaucracy, you have to push very hard, but I think we're getting it done.

The CHAIRMAN. That's why I wanted to change the term from "influence" to have you use stronger terms.

It's interesting, Labor is the one that has a great deal of responsibility for the employment problems of this country, and here I think it is an avenue that they could use—should have used a long time ago, and apparently continue to resist for whatever reasons, bureaucratic problems. But that avenue is very important. It is a very important source of mortgage funds.

So I would hope you would continue to elicit whatever cooperation you can: If you need a 2 by 4, I would be glad to help, to supply you one.

Secretary PIERCE. Thank you very much. I may come and borrow it.

The CHAIRMAN. Maybe a 4 by 4 would be more appropriate! [Laughter.]

MORTGAGE REVENUE BONDS

Have mortgage revenue bonds supported the improvement in housing now under way?

Secretary PIERCE. The mortgage revenue bond——

The CHAIRMAN. The mortgage revenue bond. They supported this improvement. They had a part of this improvement in the housing starts now under way?

Secretary PIERCE. Oh, yes, mortgage revenue bonds are important. They have played an important role.

The CHAIRMAN. Do you think they should be continued for single-family housing?

Secretary PIERCE. At the moment, the decision in the administration is to have them sunset in December. The feeling is that interest rates will be low enough at that time to handle the situation. We will not need the mortgage revenue bonds, but I'm sure that situation will be looked at again, probably——

The CHAIRMAN. I hope so. I've heard that for the last 4 years. Interest rates were always going to be better. So we didn't need there bonds through two administrations. I personally think they should be extended. Interest rates are down; fine. If they're not, as you stated, it's an important part of the housing recovery. I person-

ally think that the bonds should be continued. They should be continued.

You indicate signs of improvement, not only in single-family building, but also multifamily construction. Would you elaborate on the factors indicating renewed strength in multi-family areas?

Secretary PIERCE. Well, we have noticed that, statistically, there seems to be some improvement in the multifamily area. The basic improvement, however, comes in the single-family area. That's really where I think the thrust of the growth is.

The CHAIRMAN. As you are probably aware, there are several bills before the Congress to provide mortgage foreclosure relief. How serious do you view the foreclosure problem, and do you expect the rate of foreclosure to continue to increase or to level off?

Secretary PIERCE. Well, since our current recession, there has been a substantial amount of foreclosure, but I want to add quickly that that amount of foreclosure is nowhere near what it was in the early to midsixties, early to midseventies, and certainly far away from where it was in the Depression years.

We think, as the economy improves, this situation will improve and that it will not be necessary to have any particular legislation to help this situation. We notice that banks and other lenders are trying to work along with people who are unable to pay. There are way more defaults than there are foreclosures. As far as the future is concerned, I do not think there will be as many foreclosures this coming year as there has been in the last year or so.

The CHAIRMAN. What is FHA's experience with insurance losses?

Secretary PIERCE. Well, when you say experience with insurance losses, we have naturally worked on this situation. FHA still makes money, but I don't quite get your point. We are making money, but we do experience some losses.

The CHAIRMAN. I recognize that you are. The net effect is still a profit in FHA, but I was wondering whether individual losses were up considerably, moderately, or what. Obviously, you have offsetting profits.

Secretary PIERCE. Moderately, I would say. It is not a significant problem.

The CHAIRMAN. Thank you, Mr. Secretary. My time is up.

Senator Riegle?

Senator RIEGLE. Thank you, Mr. Chairman. I will have some questions for the record, Mr. Secretary, related to the items in the budget brought forward———

The CHAIRMAN. If the Senator would yield for just a moment, at this point I would say, being the first Monday after recess and the problems of the storm, there are a lot of Senators that wish to be here. I would expect there will be many questions for the record from different Senators besides Senator Riegle. I have additional questions, but with the number of panelists we have today, in order to get through all of the testimony, and have at least one round of questioning for each Senator that is here, all of my colleagues would expect to have numerous questions submitted to the witnesses in writing for their response for the record.

So I will, at this point, say that once, so that will take care of the problem.

Senator RIEGLE. Very good.

There are a number of specific items that I know many of us want to inquire about, and we will do that in the form of written questions. In your presentation you indicate that 9 million new households will enter the housing market in the next 5 years. Is that a net figure?

Secretary PIERCE. You're saying net?

Senator RIEGLE. Does that take into account those people who die or drop out of the housing market?

Secretary PIERCE. These are net, if you want to put it that way.

Senator RIEGLE. I know, but that doesn't tell us very much. In other words, does that mean that we will have to provide for 9 million new households on a net basis over the next 5 years?

Secretary PIERCE. Yes, we would expect that would be the number of new households. Of course other households would drop out.

Senator RIEGLE. What do you think the current shortage of housing is given the fact of the recession, the historically low level of housing starts, and the need for people to double up into existing housing units, and so forth? What do you think the backlog is of people that are jammed now and haven't been able to move out into housing, housing that has not been built for them?

NO RENTAL HOUSING SHORTAGE

Secretary PIERCE. Actually, I think we're seeing things two different ways. We had a study made by Rand Corp. which found that there was no rental housing shortage nationwide in this country. There may be pockets of shortages, but no nationwide shortage. And so therefore, we don't think the Nation is way behind in building housing.

Senator RIEGLE. So you accept the conclusions of the Rand study?

Secretary PIERCE. Not just me.

Senator RIEGLE. I'm addressing the need for rental housing.

Secretary PIERCE. You're just talking about rental housing. That's the most recent study I know. I don't know of any other studies. I hear people project this. They say, "We're short," "We're this and that." The Rand study is the only study I know that's been made recently.

It has been examined thoroughly by our Office of Policy Development and Research, as well as by the President's Housing Commission and has been accepted by them. That's the only study that I know of recently.

Now if you can tell me of some other study, I'll be glad to read it. I hear these things, but I don't know of anybody who says, "Look, Sam Pierce, here's a study. Here's something. We have had this worked out and studied."

I hear all this talk, but I don't find the studies.

Senator RIEGLE. I'm trying to establish what your assessment of the rental housing market is. Is it your judgment, that in the aggregate, there is no rental housing shortage in the country today?

Secretary PIERCE. In the aggregate, but there are pockets of rental shortage, and that's why when I come here, in the next months we'll talk about some of the ways we want to address that.

Senator RIEGLE. Can you estimate the number of people that would like to purchase a home, how many housing units are available for purchase? What is your professional judgment in this area?

Secretary PIERCE. Houses available for purchase? We know now from the latest studies, that we have 5.8 months of housing inventory available. That's new housing ready for purchase. The amount of inventory housing available is going down so that will encourage more building. In addition, there is a substantial amount of existing housing available.

Senator RIEGLE. Do you have any way of measuring the number of people who are presently either renting or want to buy, who are ready to buy, but they don't feel they can do so, because interest rates are too high including those people who are doubled up in rental units, either with family members or others?

Secretary PIERCE. The best I can say to that is, I can tell by the drops in FHA interest rates. We can tell that for each half a percentage point the FHA interest rate decreases around 600,000 to 800,000 more families become financially able to buy homes. So you can see that quite a few people will be able to buy homes as interest rates drop. In other words, the more interest rates come down, the more people will be able to buy homes.

Senator RIEGLE. So for every half percentage point drop, another 600,000 to 800,000 families become eligible to buy homes?

Secretary PIERCE. That is correct. From the time FHA interest rates were at a high of 17½ percent to the present time when the rate is 12 percent, each drop of a half a percentage point meant, that on average, about 600,000 to 800,000 more families would be able to buy homes.

Senator RIEGLE. Is this a fairly steady relationship?

Secretary PIERCE. It about averages out at about that. It may be higher at one point, a little over, but it comes out to about 600,000 to 800,000.

Senator RIEGLE. Many builders have said to me, "If we can get interest rates to 12 percent or lower, that really starts to open the market up in a significant way. At rates of 12 or higher, it really starts to close down in a significant way."

Would you agree with that?

Secretary PIERCE. I would agree with that.

Senator RIEGLE. What I'm wondering——

Secretary PIERCE. But naturally, the lower you go——

Senator RIEGLE. Absolutely. But if 12 is roughly the breaking point, I wonder how many people out there have wanted for a period of months and years to buy a house of their own, but have not been able to do so, because the interest rates have been too high?

I would like to have some sense of the number of households that fit this category so that it could be added to the 9 million new households you are projecting will be created in the next 5 years. This is critical for establishing housing needs. Do you know how many people might fall into the first group, that is people waiting for the interest rate to drop?

Secretary PIERCE. I can't tell you. It's all involved in existing housing as opposed to new housing. People move out. People die. It is a very difficult thing to estimate.

Senator RIEGLE. It seems to me some effort should be made to try to determine this number if your Department is going to map out housing strategy for the future.

Secretary PIERCE. I have a great belief in the law of supply and demand in the private sector, and they will build the necessary housing as it is needed.

Senator RIEGLE. Your reply does not address the issue. For people I talk to in my State, who want to buy housing, the issue of supply and demand right now really isn't particularly relevant to them. They want to buy, but the interest rates are out of reach, and they can't afford to purchase homes.

The builders, as a result, are not able to build the houses.

Secretary PIERCE. What you are saying is what is the interest rate at which people will buy houses. It changes. As it goes down, you get more of the population that can afford it, and they will buy.

Senator RIEGLE. I am troubled by the fact that you do not have a sense for how many people are out there now who need housing and haven't been able to afford it.

Secretary PIERCE. I really don't think that we have as serious a problem as you seem to think. I think there are people who would like to buy a house, they want to experience the American dream, but they certainly—most people, except for the very poor, the very needy, do have places to live, and they are adequate.

They might want a better house. They may not want to rent anymore. There are a lot of things. But I do not see this great shortage that you see.

Senator RIEGLE. Isn't that interesting?

Secretary PIERCE. I just ask you, Senator Riegle, give me the study, give me something that somebody has studied which you can cite.

I can't—you know, I can't just pull things out of space. I go on the basis of what I know. I know that I received that study from the Rand Corp. That is the only one I know of right now.

If you have got some study—and I hear people say what you are saying all the time.

Senator RIEGLE. Why don't you do the study? Your agency should do the study and bring it to us either to show that there is a problem or that there is not a problem.

I think it is amazing——

Secretary PIERCE. As I said, we just had this one done. We don't see that.

Senator RIEGLE. But that was before.

Secretary PIERCE. All right, we are constantly looking at these kinds of things. We don't have a complete study. I don't know anybody who has.

But maybe you are right. Maybe we should do one to try to find out more. But I think right now we are not really experiencing the shortage that you see.

Senator RIEGLE. Except that you yourself said you hear this comment. So you are hearing it from other people.

I think it would be good to look at it. I think it is useful to have the Rand overlook study, and I am glad that was done.

This period of high interest rates has forced a lot of people into existing housing and rental situations, when they desperately want to get into the housing market because their families are expanding but have not been able to afford to do so.

If, for example, you had a backlog of 5 or 6 million households that are waiting out there to go into housing and you add that to the 9 million households that you are projecting——

Secretary PIERCE. You see——

Senator RIEGLE. That is an altogether different dimension.

Secretary PIERCE. We don't see it at all, because we think you are guessing. But I will tell you what we will do. Let me give you more on this from our PD&R people. We will give you some more, but that is where we are right now.

Senator RIEGLE. I think we need to have a better answer than that. I would appreciate whatever you can do.

[The following was received for the record:]

In 1981, PD&R prepared a report on rental housing in response to a Congressional request. It was entitled "Rental Housing: Condition and Outlook." It concluded that, as of 1980, there was no nation-wide shortage of rental housing. The 1982 National Housing Production Report of the President, sent to the Congress on February 3, 1983, reached the same conclusion, noting that the rental housing stock grew every year from 1973 through 1980. Data from the 1981 Annual Housing Survey show that the rental stock, both occupied and vacant, increased from the end of 1980 to the end of 1981, and the rental vacancy rate increased from 5.1 percent in 1980 to 5.3 percent in 1981. Data from other surveys indicate that the rental vacancy rate has been stable or rising slightly through 1982. Thus there is still no evidence of a rental housing shortage. As far as home sales go, from 1968 through 1982, an average of 3.1 million new and existing units have been sold each year. On this basis, there was no shortfall in sales in 1979 or 1980, but over the 1981 to 1982 period sales were down by a cumulative 1.1 million units. Current mortgage interest rates should enable much of this deferred demand to be met this year.

The CHAIRMAN. Let me make a comment before I turn to Senator Heinz on this issue.

I wear two hats as a Senator now. The other one is chairman of the HUD Appropriations Subcommittee, where we are dealing with the actual appropriations. We have not made these available yet, but we have been doing some internal studies.

PRIORITY TO INADEQUATE OR SUBSTANDARD HOUSING

I don't think there is as much conflict between what the two of you say as you might believe, because there is a big difference between people who need housing who are not now living in adequate housing, and those living in substandard housing, not adequate because of size of family, doubling up, and want. I think that is maybe where the discrepancy in your numbers come.

Many people who are in an adequate home, would like to move up to a better and nicer one, and the homebuilders would like to build it. We would all like to see that happen. We have a flow chart that breaks down—I don't have it with me today—but it breaks down from totals various categories all the way through.

So there is a big difference in the number of people who are really living in substandard and inadequate housing that should be improved and those who would like to move up to better, even though they are currently in adequate housing, with good plumbing and sanitary conditions and all of that.

When people are talking about these large numbers of 13 and 14 million, I don't dispute that there are that many people around who would like to improve their housing status, but I would be happy to show the Senator the Appropriations Subcommittee study because the totals are broken down into six or seven, eight different categories.

I wish we could build them all. The realtors, homebuilders, everybody wishes we could. But I think we need to make that distinction between various levels of need, and obviously the first priority are those who are in inadequate or substandard housing.

We could also make those estimates. It isn't done by the Rand study, but can be found going back through our own records. It is internal from the HUD Appropriations Subcommittee. It would be interesting to both of us.

Senator RIEGLE. Mr. Chairman, before you move on, in relationship to your comment, if you would yield, I think it could be very useful, and I think it is important to try to establish the extent to which there is a backlog need for housing in the country.

Logic would tell us that there is a backlog, given the length of the recession, the way interest rates have been so high on home mortgages, and the fact that housing starts have fallen way off. The number of people moving into housing now over a rather long period of time is with us, and what I am hearing bears that out—there are a substantial number of people out there who are jammed in the pipeline.

I think it is awfully important that we try to size that group. If it is a million, that is one thing. If it is 3 million, that is something else. If it is 5 or 6, that is something else again.

But from the point of view of housing policy, we ought to start with an understanding of what our current problem is before we make projections on the future.

The CHAIRMAN. I don't disagree. I just wanted to make the point that there are various levels of need. As far as Government housing policy, which we deal with, I think our primary responsibilities are to those who are in Government subsidy programs. Those we deal with should be those who are truly in need of better, more adequate housing.

The larger numbers I think have to come from the private sector. It is amazing, I think we would all be surprised what 2 or 3 percent lower interest rates would do in reduction of our total demand. There are an incredible number of people out there waiting to upgrade themselves into different housing.

That includes somebody who is maybe living in a $100,000 home who wants to go to $150,000 home.

The point I was trying to make is that there are large categories that I am crying tears over because they can't make their move; even though it would be good for the economy and homebuilders. It is people in the lower categories who are having really serious problems. That number is quite a bit lower than the total that we are talking about.

I don't really think we disagree, we are talking about specifics within those numbers.

Senator Heinz, thank you for your patience.

Senator HEINZ. Mr. Chairman, thank you.

Mr. Secretary, you and I on many occasions have talked about the priorities of your Department, and you have said to me, as I believe you have to others, that your two highest priorities are to make housing affordable for first-time homebuyers and second to address the needs of low-income people who cannot afford housing.

This hearing has concentrated principally on the first priority, and appropriately so. You have given us some encouragement with your review of facts and your statistics from the department.

I must say, though, that I do not share your optimism regarding your ability to work out with the Department of Labor some meaningful changes that would make pension fund money available for home mortgages.

Unless I have the year wrong—I think it was in 1978 that Senator Javits and I worked out on the floor of the Senate an amendment directing HUD and the Department of Labor—he was ranking minority member on Labor and Human Resources at that time—directing your two departments to get something done and get it done within a year.

Here we are five years later, and nothing of any real substance, as you yourself are frank to admit, has been forthcoming. You have stressed the bureaucracy.

PENSION MONEY UNDER LOCK AND KEY

Let me tell you, I think we ought to face the fact that 5 years from now we will be no further down the road from that. The bureaucracy is going to keep mortgage pension money under lock and key, and I will tell you why.

There are some macro economists, often lodged down at the Council of Economic Advisers in every administration, but not exclusively there, who will point to charts that will show that there is, to their view, an unhealthy amount of money going into mortgages and not enough going into corporate investment. And as long as those people believe that, they will find ways to frustrate you and anybody from the Department of Labor.

Therefore, Mr. Chairman, I suggest 5 years from now we will be discussing this same issue, why haven't they moved more quickly, because there are going to be people not just in your bureaucracy and the Labor bureaucracy, but down in the White House bureaucracy and the Treasury bureaucracy, who is going to fight you tooth and nail.

The CHAIRMAN. If you got a 4 by 4, you can add it to mine.

[Laughter.]

Senator HEINZ. A 4 by 4, Mr. Chairman, should only be looked at as kindling for the fire that we will have to build.

The CHAIRMAN. At least one of us on the committee gave them a 2 by 4 with a 4 by 4, and they can get them of all sizes.

Senator HEINZ. Then, as I say, you might put real logs on the fire. You might begin to raise the temperature 2 degrees.

In any event, in your review of the increase in housing starts, I trust—I hope you are aware that in the Northeast and, even to a more significant degree, the Midwest, the Midwest and Northeast have not shared in the increase of housing starts.

In the Northeast it is down 5 percent.

Secretary PIERCE. I am talking about the nation as a whole.

Senator HEINZ. Even though the applications for building permits have increased somewhat in those areas, they have increased at a rate below the national average as well.

So I know you must be aware of the great regional problem that we have in the Northeast and the Midwest in this regard.

That impacts, in particular, on the question of mortgage foreclosures. It is obvious to the commonsense that those areas with the most persistent and high unemployment, whether it is Pittsburgh and the steel industry or Detroit and the auto industry, are going to have much more severe mortgage foreclosure problems than other areas of the Nation.

Mr. Chairman, I want to put in the record a letter I received this month from Action Housing, Inc. of Allegheny County which documents the very serious problems that we have in our four-county area where there are some 15,000 mortgages in the Pittsburgh—the four-county area that are delinquent on their mortgage payments.

About 50 percent are due strictly to unemployment or economic hardship. That means they are about to go bankrupt.

There are 2,000 homes in this small area of Pennsylvania that are at some stage of the foreclosure process itself. There are another 22,500 mortgages near deliquency and one-third to one-half of those individuals face a very high risk of displacement.

Lord knows where they would go if they go delinquent. And even with the recent 6-week extension in unemployment benefits, many of the individuals surveyed are going to lose those benefits by May 1983, and if no replacement job is found, delinquency is going to follow, and the loss of benefits—delinquency will follow the loss of benefits within 1 to 2 months.

That, I am sure, is no surprise to you. So I would—without going on at length on these statistics, I would suggest that there are regions of the country that are going to face persistently high levels of unemployment despite a few encouraging signs.

We will not get but fractions of those people back to work. The administration's forecast for improvements in the economy, as we all know, are modest, and it is the administration's own economic forecast that suggests that we are going to have real and continuing and growing problems on mortgage foreclosures in areas in the Northeast and Midwest.

So I don't think that is an issue you can look at and say things are getting better. There are areas of the country where it is not going to get good enough fast enough.

[Letter follows:]

ACTION-HOUSING INC.,
Pittsburgh, Pa., February 4, 1983.

Hon. H. JOHN HEINZ III,
U.S. Senate, Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR HEINZ: Enclosed for your information is a copy of ACTION-Housing's recently completed study, "The Impact of Unemployment on Mortgage Delinquency and Foreclosure in Allegheny County and a Proposed Program of Assistance." Based on interviews with 351 unemployed steelworkers and data gathered from the Mortgage Banker's Association and other sources, we have found that:

Approximately 15,000 mortgagors in the Pittsburgh four county area are currently delinquent on their mortgage payments, about 50% due to unemployment or economic hardship.

2,000 homes are at some stage in the foreclosure process.

22,500 mortgagors are near delinquency and one-third to one-half of these individuals face a high risk of displacement if they go delinquent.

Even with the recent six week extension in unemployment benefits, many of the individuals surveyed will lose their benefits by May 1983. If no replacement job is found, delinquency will follow the loss of benefits within one or two months.

Mortgage delinquency imposes a hardship on local lending institutions as well, costing them about $4.5 million per month in cash flow.

In order to develop an effective response to this problem ACTION-Housing established a 20 member task force in December, 1982, consisting of eight local lending institutions, public officials, unemployed persons and various civic and community leaders. The proposed assistance program developed by this task force contains six basic elements: (1) a "talk to your lender" campaign, aimed at encouraging unemployed homeowners to discuss their mortgage problems as soon as possible with an appropriate official of their lending institution; (2) partial payment plans, forbearance and refinancing options to be worked out between the homeowner and lender; (3) financial and legal counseling to be provided by five local non-profit agencies; (4) increasing the acceptance rate and overall effectiveness of the existing FHA and VA mortgage assignment programs; (5) a temporary mortgage assistance program to be initiated in the Pittsburgh area on a pilot basis by the Mortgage Guaranty Insurance Corporation, the nation's largest private mortgage insurance company; and (6) a mortgage foreclosure prevention fund, financed with public and private contributions, to be utilized as a last resort to prevent foreclosure.

This proposed six point plan has been designed to utilize the resources of both the private and public sectors of this community in a unified and positive way to deal with an urgent community problem. I want to emphasize, however, that the proposed plan in no way precludes appropriate and necessary action at the state or federal level to deal with this problem. Indeed, we strongly encourage you and your colleagues, in Congress to develop ways and means of assisting with our overall effort. Action of the federal level is particularly important since this is not just a local problem but is impacting on many major industrial cities in the Northeast.

Thanks very much for your interest in this project and for your past support of ACTION-Housing's programs and activities. I will be pleased to provide you with any additional information you may desire concerning the mortgage delinquency assistance program

Sincerely,

JONATHAN E. ZIMMER,
Executive Director.

MORTGAGE REVENUE BONDS

Senator HEINZ. Now I really want to ask you two questions. One, I think, is perhaps a brief question. We have—we make good use of mortgage revenue bonds in our State, as do other States.

You yourself indicate a sunset of those provisions in December of 1983, this year, and you said that you felt that such a sunset was appropriate because interest rates would continue to drop.

Let me ask you quite bluntly at what level of interest rates you think mortgage—the continuation of mortgage revenue bonds would be unnecessary?

Here we are today, we are at the 12 and 13 percent on FHA and conventional. What do we need to drop to before mortgage revenue bonds are unnecessary?

Secretary PIERCE. I would say a couple of points, about 10, 9 or 10.

Senator HEINZ. If we can get down to 9 or 10, we wouldn't need them; above that we probably would?

Secretary PIERCE. That is right.

Senator HEINZ. My main inquiry, Mr. Secretary, would be this. I certainly hope that we can improve the affordability of housing, both FHA and conventional, for the American people.

You indicate that there are about 10.5 million families now eligible for affordable housing at the 12-percent rate, but what—can you bring this down to, first, people who essentially would be first-time homeowners—10.5 million families, as I understand, covers everybody.

Secretary PIERCE. That is right.

Senator HEINZ. That is equivalent to there being roughly 60 million families in the United States. That is 1 family in 6 among everybody.

Where are we with respect to first-time owners?

Secretary PIERCE. I would have to try to get that statistic for you from the Office of PD&R, because off the top of my head I wouldn't know. I would say that most of those people would probably be first-time home buyers, by commonsense. But I don't know the exact number. But I can probably get it.

Senator HEINZ. I would appreciate that.

Secretary PIERCE. Let me try to get that for you from PD&R.

[Information follows:]

Less than 10 percent of these people are now renters, so under 1 million is the maximum for first-time homebuyers among them. Many of the rest, of course, would be interested in trading up to a better home or a new home.

About 14 percent of all renters, or over 3.9 million renter households, have incomes greater than $25,000. The majority of them could afford the FHA $60,000 mortgage repayments if they were willing to use one-third of their income for this purpose.

Depending on interest rates, any where from 10 percent to 40 percent of homebuyers are first-time homebuyers. In times of high interest rates, the proportion is smaller.

Senator HEINZ. Let me express this concern. If we do not adopt or do not find an equivalent means of achieving the President's budget reductions from the anticipated deficit that would otherwise result not just for 1984 but for 1985 and 1986, it is estimated that in the coming year the deficit will amount to 116 percent of net savings.

What would happen to the mortgage interest rates if there was no action by the Congress to reduce deficits and deficits did, indeed, result, amounting to 116 percent of net savings? What would happen to mortgage rates—all the savings available?

The deficit would be larger than the amount of money the American people were saving.

Secretary PIERCE. If you had that situation, then I would imagine there would be a good chance that interest rates would go up.

Senator HEINZ. I agree with you 116 percent. [Laughter.]

Now, with the President's proposed reduction, that deficit is estimated to be 85 percent in the coming year of net savings. Now, to my mind that suggests that it's going to be pretty hard to get any further decrease in interest rates—maybe we'll get some if inflation continues, thanks to the oil price, to go down a little bit—but my question to you is this: If indeed we come out with the President's numbers and if indeed that is equivalent to 85 percent of net savings, is that going to be enough to bring interest rates down to any significant degree—mortgage interest rates?

Secretary PIERCE. The trouble is I don't think it's a yes or no answer. I think there are so many factors, one of the principal factors is the psychology that's involved.

Interest rates sometimes go up—and one of the reasons I think they stayed so high for so long recently was because the financial markets did not believe that the Government was sincere when it said it was going to reduce its deficits and that it was going to cut down on its programs and so forth. They thought the Government was going to go right back to the same old way of big spending.

Senator HEINZ. For good reason, Mr. Secretary.

Secretary PIERCE [continuing]. So therefore interest rates did not come down. What I have referred to is a psychological factor that is very, very significant. Interest rates do not go up or down just because of a certain number: It's not automatic.

Senator HEINZ. No, it's not. But with all that taken into account, do you think—let me put it a different way: do you think——

Secretary PIERCE. I would not make any guess on it.

Senator HEINZ. Let me put it another way: Do you think that even if we did everything the President has proposed and got to his bottom-line numbers on the deficit, that that is truly enough in the way of deficit reduction to insure that you get the kind of reductions in mortgage-interest rates—you are talking about 9 and 10 percent respectively for conventional and insured that you would like to see? Are we doing enough to reduce the deficit?

Secretary PIERCE. I think we are doing all that we can under the circumstances. I would like to see a greater reduction myself. I think that we need to have a greater reduction, but politically, realistically, you here in the Congress really know better than I that the various pressures of many groups of citizens make that objective difficult to attain. I think realistically that is where it is at.

But if you ask me theoretically what I think would be best for this country, I would like to see a greater cut in Government spending.

Senator HEINZ. Would you agree that we run a significant risk about, not just housing production, but about having a sufficient market for the housing produced unless we do find a way to do better?

I would assume you would agree with that.

Secretary PIERCE. I will agree that the more you are able to reduce Government spending, I think the better it will be as far as the economy generally and interest rates in particular are concerned.

Senator HEINZ. Mr. Secretary, thank you.

The CHAIRMAN. Senator Lautenberg, you have any questions?

Senator LAUTENBERG. No, thank you, Mr. Chairman.

The CHAIRMAN. Senator Riegle?

Senator RIEGLE. Yes, Mr. Chairman, just one other thing. I know we have a long list of witnesses today and we can keep the Secretary here quite a long time ——

The CHAIRMAN. We have 11 more witnesses; if we go at this rate, we'll quit about 10 o'clock tonight. But go ahead.

FORECLOSURES

Senator RIEGLE. I want to followup on a very important line of discussion that was being asked a few minutes ago with respect to people who are unemployed and facing foreclosure on their homes.

I don't know if you have seen the data, but in 1982, mortgage defaults were at the highest levels on record. In the third quarter of last year, there were 219,000 mortgages nationwide that were over 90 days past due——

Secretary PIERCE. Wait a second. Differentiate between default—you're talking about defaults——

Senator RIEGLE. I'm coming to that in just a minute.

Secretary PIERCE [continuing]. Or foreclosures? Because there's a tremendous difference.

Senator RIEGLE. Let me give you the numbers, and if you have disagreement, we can discuss that. In the third quarter of last year, 219,000 mortgages nationwide were over 90 days past due. There were over 171,000 mortgage loans in foreclosure proceedings. That's 171,000 foreclosures nationwide, with over 10,000 in my State of Michigan. There are an enormous number of people who because of unemployment and the exhaustion of their savings and unemployment coverage and so forth, are not able to maintain their payments, and are finding themselves further and further in arrears and eventually into foreclosure proceeding.

I'm really struck by the fact that there were 171,000 loans in foreclosure at the end of this last year. That seems like a very large number to me, especially when we compare that level with prior experience. We know they are linked quite directly to the unemployment that has hit on certain sectors of the economy.

EMERGENCY ASSISTANCE

On February 3, 1983, 10 of my colleagues and I introduced the "Emergency Homeowners' Relief Act of 1983" to address this problem. This legislation would provide emergency assistance to people with conventional mortgages who are unemployed or underemployed and in arrears on their mortgages.

The bill would authorize HUD to advance people enough money to cover 3 months of arrears payments and provide up to 80 percent of the cost for mortgages, taxes, and insurance for a 12-month period.

Funds would be targeted to the areas of the country where the delinquency rates are the highest with approximately 100,000 unemployed homeowners taking advantage of the program. The estimated gross outlays for this program would be $750 million over a 3-year period. However, since assistance is in the form of repayable loans, the final net cost would be much lower.

I am just wondering how you feel, given the fact that we are in an unprecedented situation. We have not seen a condition like this since the 1930s, and in the 1930s we didn't have the scale of homeownership which we have today.

Can you support this effort to help homeowners who are suffering from the recession?

Secretary PIERCE. Well, off the top of my head—I haven't studied your proposal, I haven't read it, but I would not favor the proposal.

I think first of all, it would discourage a lot of lending institutions to do what they're doing now. What they're doing now is they are carrying people and making new arrangements and so forth. If the Government stepped in, they would turn it all over to us and we would have to take everything over, and they wouldn't continue what they are doing.

Also, as I said to Senator Heinz, I want to try to keep Government spending as low as possible because I think in the long run that's the best for our Nation right now.

IMPRACTICAL PROPOSAL

I just think that this proposal is impractical, will probably be very difficult to run, will take a great deal of staff—we would have to go into almost every city and county in the Nation with it—and I think it would be setting up a massive, complex administrative machinery that in the long run would not be necessary because I have great belief in our economy turning around.

It's true there will be some people who will have a tougher time than others, and that's certainly unfortunate, but there are ways and means of trying to help them along.

As I said, the lending institutions are doing a lot about that right now. We at HUD are also able to help. We have a mortgage assignment program through which we are assisting some people, so we are working on this problem. In addition, there are other practical ways of assisting those in need on a temporary basis of doing it.

I do not see setting up this giant complex administrative machinery at this time when our basic goal is to try to keep spending as low as we possibly can, because it such a significant factor in turning this Nation's economy around.

Senator RIEGLE. I'm sorry you feel that way. I just want to give you the numbers here: At the end of the first quarter of 1980, we had 86,000 loans in foreclosure; at the end of the year 1980 that number had gone up to 102.

Secretary PIERCE. What were they in the early sixties and seventies? Give me those numbers; give me the numbers in the early sixties and seventies.

Senator RIEGLE. I don't have those.

Secretary PIERCE. I think you'll find that they're higher than those.

Senator RIEGLE. You've got staff people here; why don't you present those? Let me give you what I have: starting in 1980—and I go back to 1978——

Secretary PIERCE. I was interested in the early seventies, early sixties.

Senator RIEGLE. We'll get to that in a minute. The fact of the matter is, in the third quarter of 1982 we were up to 172,000 in foreclosure.

Basically, what I hear you saying is you're prepared to walk away from that problem.

Secretary PIERCE. We're not walking away from it.

Senator RIEGLE. What are you doing about it, what are you doing about the homes that are in foreclosure right now? Nearly 200,000

of them. What are you offering the people that are in that circumstance?

Secretary PIERCE. I tell you, we have our mortgage-assignment program in connection with our FHA program.

Senator RIEGLE. How many of those people have you helped?

Secretary PIERCE. I can't tell you off the top of my head.

Senator RIEGLE. Who can tell us?

Secretary PIERCE. We can get the material and put it in the record for you.

Secretary RIEGLE. There isn't anybody here with you that can give it to you?

Secretary PIERCE. No one here has that information.

Senator RIEGLE. Is it half of these people?

Secretary PIERCE. We don't know; we'll find out.

Senator RIEGLE. Do you think it's as high as that?

Secretary PIERCE. I don't know.

Senator RIEGLE. I would be very much surprised if it was. I'm surprised you don't know the answer.

Secretary PIERCE. Why are you surprised? You didn't know about the sixties and seventies. [Laughter.]

Senator RIEGLE. We're not living in the sixties, Mr. Secretary, we're living right now.

Secretary PIERCE. We were comparing it—but we will get you those figures, and also think of——

Senator RIEGLE. So in terms of foreclosure——

Secretary PIERCE. Think of this as not just the Federal Government being involved. What are States doing, what are local governments doing?

Senator RIEGLE. The question is, what are you doing? Apparently you don't have any answer.

Secretary PIERCE. We can get you the answers for what you want to know.

Senator RIEGLE. My understanding is, the delinquencies right now are higher than they have been since we kept recorded statistics on the issue.

Is it your feeling in the sixties they were higher than they are now?

Secretary PIERCE. Foreclosures?

Senator RIEGLE. Yes.

Secretary PIERCE. Yes, it's my feeling, in the early sixties, early seventies, foreclosures——

Senator RIEGLE. I think you may be in error on that; we'll check it. But the fact of the matter is we have nearly 200,000 now. As far as I know, you have no directive for dealing with that problem.

Senator HEINZ. Mr. Chairman?

The CHAIRMAN. Mr. Heinz?

Senator HEINZ. I have a brief question; I have a brief opening statement too. [Laughter.]

The CHAIRMAN. I am fine, it's just the 11 witnesses I am worried about.

Senator HEINZ. Mr. Chairman, since I brought up the subject of mortgage foreclosures, I will attempt, perhaps with modest success, to have the last word, but let me just say I think there may be an apples and oranges question. Senator Riegle, Mr. Secretary, was

talking to you about delinquencies, you were talking about foreclosures.

As I understand the statistics, foreclosures are based on available data, have not yet exceeded the statistics of the middle sixties. However, delinquencies may indeed be at their all-time level and those are not inconsistent, because there has been a major effort, at least in all the communities that I am familiar with, to do, Mr. Secretary, what you have suggested, which is that there be a good deal of lender forbearance, and there have been tremendous initiatives in this regard. Indeed, in the letter I am submitting for the record, they spell out a seven-point program of lender forbearance, and that kind of local lender initiative is indeed to be encouraged.

But I believe there are absolute limits on the extent to which forebearance can occur, as we know, so my question to you is this: Would you react more favorably to a mortgage-foreclosure-assistance program that observed at least the following principles: First, that it would not involve any more than $100 million; second, that the entire $100 million would be recapturable: There would be provisions to recapture them; third, that it would not create any new Federal bureaucracy; and fourth, any assistance under such a program would be premised and depend largely on lender—local lender forbearance initiatives?

Secretary PIERCE. That would be more along the lines of something I would agree to.

Senator HEINZ. Well, I will be making public a proposal that follows those principles shortly. I look forward to discussing it further with you and other members of our committee.

Thank you, Mr. Secretary.

The CHAIRMAN. Senator Hecht, before we release the Secretary, do you have any questions you wish to ask?

Senator HECHT. No, I don't.

The CHAIRMAN. Gentlemen, I apologize for having to schedule so many witnesses today, but when we planned this hearing we wanted to do it early in the session. Looking at the schedule for the rest of the week with Appropriations Committee hearings and other authorizing committees, spreading this hearing out to 2 days seemed virtually impossible with all of the conflicts. Because there are a large number of witnesses, it will take some time, and I felt it was necessary to allow everybody to have their opportunity when we did have so many conflicts.

Mr. Secretary, I thank you for your testimony today.

Could I have the first panel come up, the Honorable Richard T. Pratt, Chairman of Federal Home Loan Bank Board; David O. Maxwell, Chairman and Chief Executive Officer, Federal National Mortgage Association; Kenneth J. Thygerson, President and Chief Executive Officer, Federal Home Loan Mortgage Corporation?

STATEMENTS OF RICHARD T. PRATT, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD; DAVID O. MAXWELL, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FEDERAL NATIONAL MORTGAGE ASSOCIATION; AND KENNETH J. THYGERSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL HOME LOAN MORTGAGE CORPORATION

The CHAIRMAN. Gentlemen, we're happy to have you with us today. Our first witness on the panel is Mr. Richard T. Pratt.

Gentlemen, if you could summarize your testimony, we will certainly include the whole testimony in the record. I knew that Chairman Pratt would be here this morning for the hearing, because we were on the same 3:00 a.m. airplane this morning. We figured if we got stuck, at least I could listen to his testimony while we were sitting in the airport in the snow.[Laughter.]

Chairman Pratt.

Mr. PRATT. Thank you, Mr. Chairman.

[Complete statement follows:]

STATEMENT OF

RICHARD T. PRATT, CHAIRMAN

OF THE

FEDERAL HOME LOAN BANK BOARD

ON HOUSING

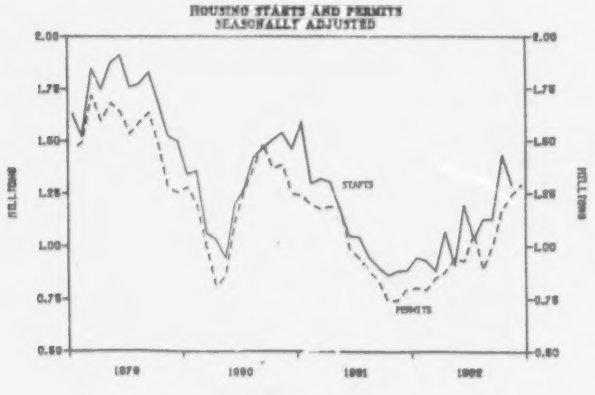
Mr. Chairman, Members of the Committee, I appreciate the opportunity to appear before you today to report on the status of housing and home finance. I see many signs that the economy is moving foward, that the housing and thrift sectors are on the rebound, and that housing may be a leading factor in the recovery.

Although a housing recovery is evident, it seems likely that 1983 will not be a year of record housing activity. The positive factors of deferred demand, demographics, and declining interest rates will be partially offset by high unemployment and long-term interest rates that are still high by historical standards.

HOUSING RECOVERY

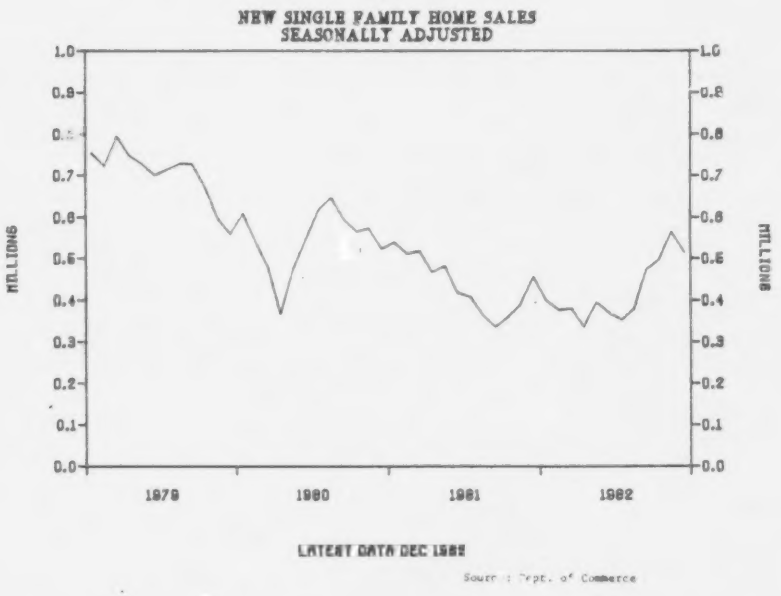
The signs of recovery in the housing market are positive. Starts in December were 43 percent higher than their October, 1981, low, with single-family starts 58 percent higher than those in October, 1981. Permits for five of the last six months have been over the one million annual rate; in sharp contrast, permits failed to reach the one million level for the twelve months before that. (See Chart 1).

CHART 1



A third positive indication of recovery is new single-family home sales. Such sales exceeded the one-half million rate for the last two months, and the December rate was 54 percent above its September, 1981, trough. (See Chart 2).

CHART 2



Source : Dept. of Commerce

Finally, the inventory situation has been and continues to be very favorable. The inventory of unsold homes has hovered around 250,000 for most of 1982, and based on the December sales rate the inventory of unsold homes represents a 5.8 months supply. Completed unsold homes have been under 100,000 since last February. (See Charts 3-6).

CHART 3

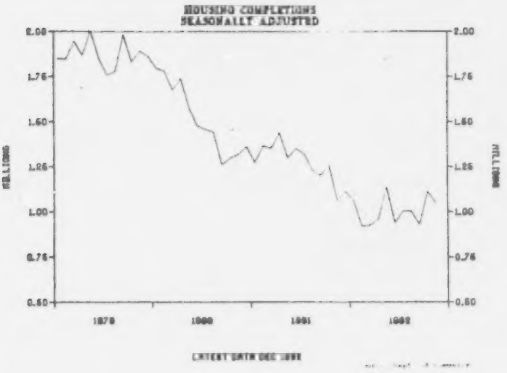


CHART 4

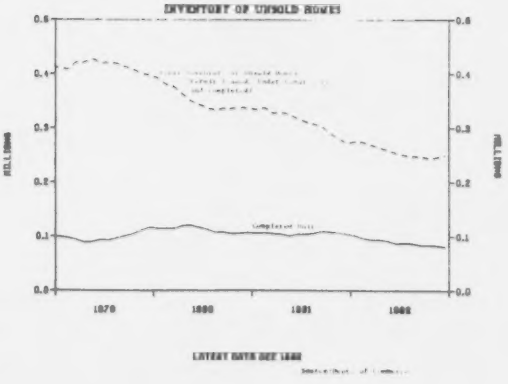
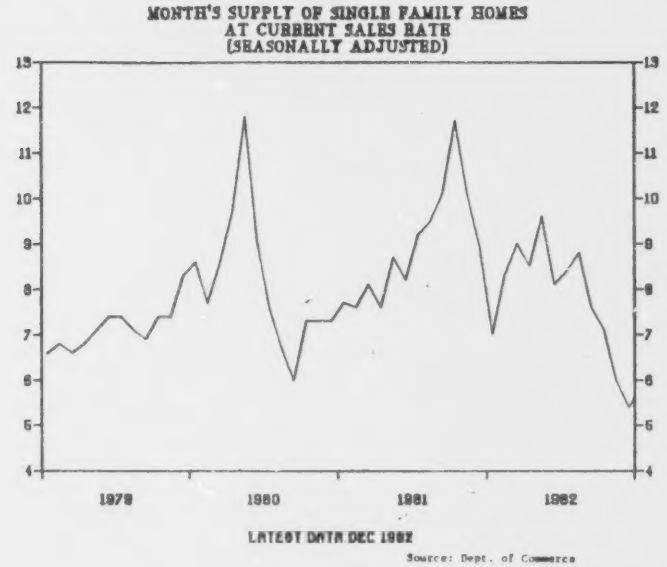
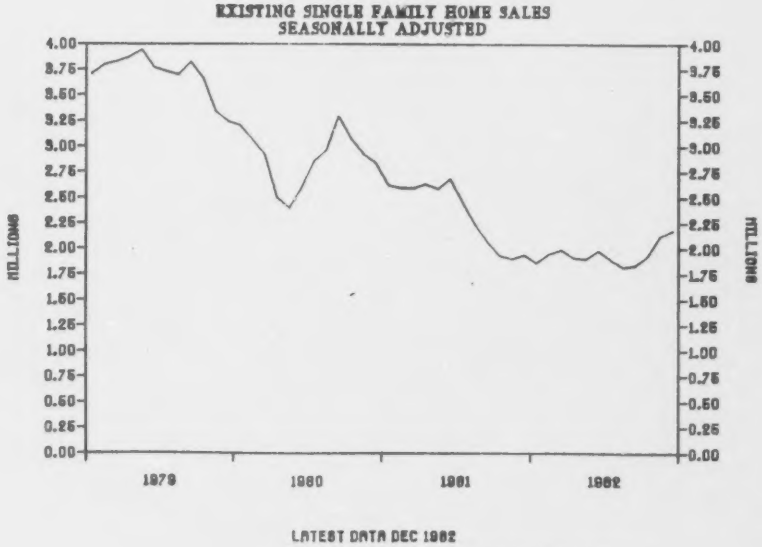


CHART 5



Source: Dept. of Commerce

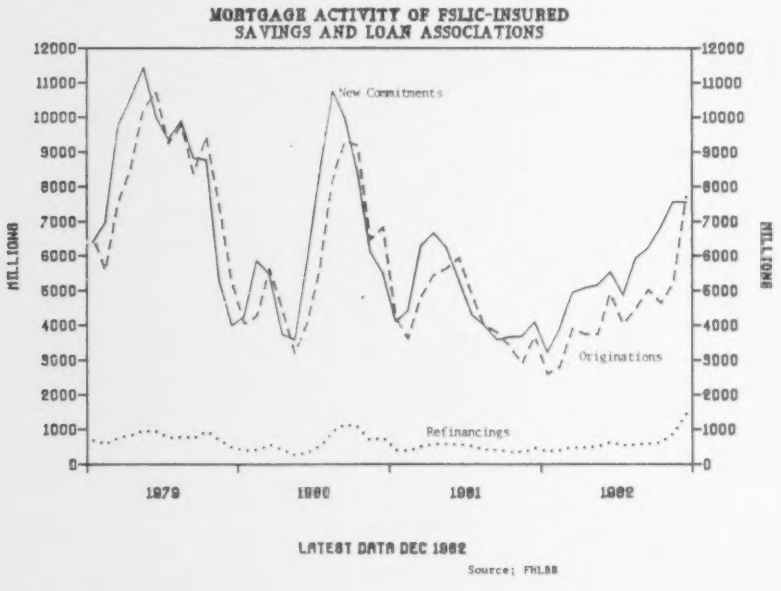
CHART 6



Source: National Association
of Realtors

The positive indications in housing starts and sales are parallelled by data showing a distinct upward trend of mortgage activity by associations. FSLIC-insured associations closed $52.3 billion of loans in 1981 and $52.7 in 1982. While these closings are less than half the record of $108.3 billion established in 1978, associations in 1982 made $10.5 billion in commitments above the 1981 level. Chart 7 shows the trends of both originations and commitments.

CHART 7



In December, 1982 associations closed more than twice as many loans as in December, 1981, and they made almost twice as many new commitments. In every month since August associations have closed

more loans than in the corresponding month the previous year. Additionally, since June, associations have made more new mortgage commitments than for the corresponding month the previous year. Finally, the combined November-December closings of $12.9 billion and new commitments of $15.1 billion are quite strong given the seasonal pattern of closings.

Even with no further improvement of the housing sector, originations in 1983 will be well in excess of their 1981-1982 levels. The Bank Board does believe, however, that a sixty percent improvement in originations to $80 billion is a reasonable estimate for 1983.

One of the emerging trends in the increased mortgage activity is a sharp increase in the level of refinancings by FSLIC-insured associations. The December level of refinancings of $1.46 billion was the highest in four years. Also, over one-third of FHA activity over the last several months is attributable to refinancing. A relatively high level of refinancings can also be expected in 1983 as borrowers refinance to take advantage of mortgage rate declines of up to five percent. Second, many "creative" financing arrangements may be refinanced as balloon mortgages become due or if borrowers choose to consolidate their mortgage debt.

Given the expectation of record financings, the current restrictions on new FHA insurance commitments and by GNMA to guarantee mortgage pools will be binding. These restrictions are designed to limit the net involvement of the government in housing and mortgage markets. Because both new financing and refinancings

come under the same ceilings, the high level of refinancings will mean that these ceilings would become binding at a relatively low net new activity levels by lenders. While enforcement of the current ceilings could cause short-run problems in GNMA markets, the private secondary market has become more efficient over the past two years. Thus, the Bank Board expects that the private secondary market will ultimately provide an outlet to the permanent investors of the mortage pools that GNMA is restricted from selling.

THE ECONOMY AND HOUSING IN 1983

The most likely economic scenario for 1983 is the one of a modest recovery for both the economy and housing. The economic recovery will be moderated by the level of unemployment and the fact that significant portions of unemployment are attributable to longer-term factors. Among these are the apparent permanent decline in demand for American automobiles, the slump in export industries caused by the strength of the dollar, and the disruptions in the domestic oil industry caused by declining prices for oil. An additional factor indicating a less than brisk recovery is the extremely low level of capacity utilization. These conditions would seem to argue for a modest recovery, but one in which a large deficit could be financed without causing sharp increases in interest rates. In sum, the recovery is likely to be modest but sustainable due to projected weak demand for capital goods.

The recovery in housing also likely will be moderate due to the high and sticky level of unemployment, high long-term interest rates, and mortgage rates still sufficiently high to deter some discretionary

moves by owners. It is important to emphasize, however, that housing in 1983 will be much more robust than in 1982 due to the substantial significant improvement in inflation and the corresponding decline in interest rates. We expect that, if inflation stays at current low levels, long-term rates will continue to decline and housing will continue to improve.

Given this moderate projection for a housing recovery, consensus estimates for housing starts in 1983 are in the 1.4 million range while existing home sales will probably exceed 3.0 million units. I believe this is a reasonable estimate which could be exceeded if favorable economic and interest rate conditions persist. Higher levels of starts and existing home sales are probably not attainable for three fundamental reasons. First, the projected deficits for FY83 and FY84 will put strains on capital markets. Consensus estimates of Treasury financing in 1983 are at least $180 billion. Second, unemployment is expected to remain high, and there is little expectation of the unemployment rate falling below 9.5 percent this year. Unemployment, the fear of unemployment, and the reduced spending caused by unemployment seem to preclude a booming recovery. Third, the latent fears of future inflation based on the size of the deficit will continue to cause a steeply positive yield curve for 1983.

The present estimates for housing starts and sales in the present recovery are also based on the Bank Board's conclusion that a number of factors justify a reevaluation of our longer-term

expectations for housing. Several years ago, most housing experts spoke in terms of 2.0 million units being needed each year in the 1980's. The principal reason cited was the maturing of the "baby boom" generation. It has been several years since that level of starts has been reached, but there is no evidence of a housing "shortage" in terms of increases in rents or house prices.

Clearly, the recession is partially responsible because household formation is postponed during recession. Beyond the factors of unemployment and high interest rates, there may be several additional reasons to revise downward longer-run housing estimates. One of these may be the voluntary doubling-up of non-related households. A second may be imprecision regarding the household formation and marriage and divorce rates of the baby boom generation. Another is the considerable discretion about the timing of net removals from the housing stock. Thus, if both demographic and replacement demand fall short of earlier expectations, we should not expect a level of starts of of 2.0 million as the standard for the rest of the decade.

There is a second plausible scenario for the economy and housing 1983 that is possible but, I believe, less likely. This scenario envisions a broad-based and robust recovery placing severe demands on credit markets. These credit demands, the projected deficits, and the lag in the receipt of tax revenues could cause a rapid run-up of interest rates. This run-up of short-term rates could burst the bubble of recovery in the economy generally, and

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for housing. I believe this scenario is quite unlikely, as all evidence seems to point to recovery, and structural factors will result in the recovery being modest.

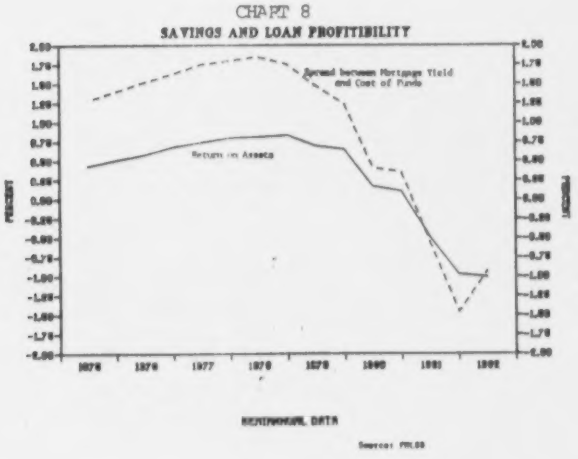
THRIFT CONTRIBUTION TO RECOVERY

During the last three years, the thrift industry has experienced its most severe earnings crisis since the Great Depression. Although the thrifts' historic losses during these years of high inflation has led to a wave of consolidation in the industry, I believe the winnowing process will prove beneficial in the long run. The responses of the Congress, the Bank Board, and the industry itself to the crisis have created a strong foundation for long-term recovery, and the recent decline in short-term interest rates already has resulted in significant improvements in industry health.

As recently as six months ago, the situation confronting savings and loan associations and mutual savings banks was bleak. Constrained by law and regulation to invest primarily in fixed-rate, long-term home mortgages, using short-term funds obtained from savers, thrifts were extremely vulnerable to the high and volatile interest rates of recent years due to the de facto deregulation of their liabilities. At the same time, thrifts' savings inflows were severely depressed by increasing, fierce competition resulting from the rapid expansion of the money market mutual fund industry, and with action by the Depository Institutions Deregulation Committee that brought a large and growing number of account categories into line with market rates. These problems were exacerbated by severe constraints on thrifts' ability to raise capital through conversion to the stock form.

During 1980, 1981 and the first half of 1982, the unprecedented level of interest rates was the primary cause of a large and expanding negative spread between thrifts' cost of funds and their gross return on assets. Thus, while the industry's gross return on assets edged up only moderately from 9 2/3 percent in late 1980 to 10 3/4 percent in the first half of 1982, the cost of funds during the same period rose more than 200 basis points, from slightly over 9 percent to roughly 11 1/2 percent during the second half of 1981 and the first half of last year. As a result of this negative spread, net operating losses of associations reached $3.3 billion in the first half of 1982, with 82% of associations experiencing losses in the first half of 1982. Chart 8 presents the primary spread (mortgage yield less cost of funds) and return on average assets for FSLIC-insured associations since 1975.

CHART 8



The problem of industry losses in 1981 and 1982 was compounded by the related pressure of severely depressed savings inflows, resulting primarily from money market fund competition. Thus, during 1981, associations experienced a record outflow of $25 billion. Including interest credited to depositors' accounts, growth in deposit balances amounted to only $13 billion in 1981, rising to about $38 billion in 1982. The increase in deposit balances in 1982 was partly due to a record deposit inflow in December, reflecting the popularity of the newly authorized money market deposit account created by the Garn-St Germain Depository Institutions Act of 1982. This inflow also reduced the net savings outflow of S&Ls for 1982 as a whole to about $6.4 billion, a sharp reduction from the 1981 figure.

Inevitably, the magnitude of the funds outflows that occurred in 1981 and 1982 greatly reduced the ability of the savings and loan industry to supply homebuyers and homebuilders with credit. In 1981 and 1982, respectively, FSLIC-insured institutions closed only $52.3 billion and $52.7 billion in mortgage loans. The 1981 figure represents the smallest lending volume since 1974, a year in which, it should be noted, the industry financed a much larger number of individual loan transactions than in 1981 because of the lower prices of homes. 1981 and 1982 also saw a continued decline in the percentage of net new mortgage debt acquired by S&Ls, with S&Ls' share dropping to just over 20 percent for 1982 from over 60 percent in 1975. This compares with a 30 percent share in 1980,

and a 50 percent share during most of the 1970s. (See Charts 9 and 10 for declining share of mortgage originations and net new mortgage holdings).

CHART 9

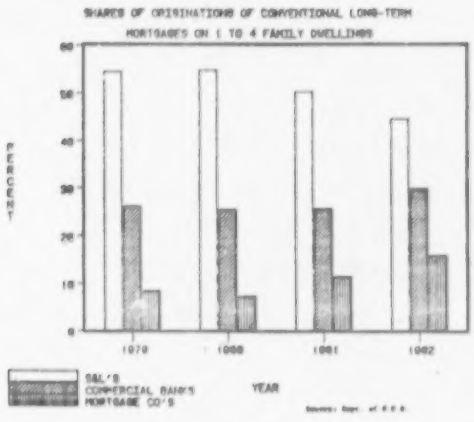
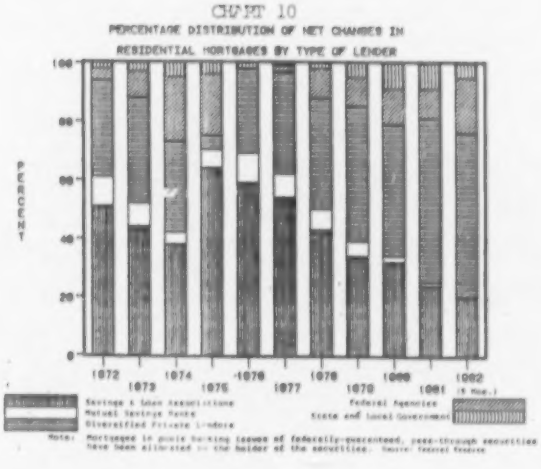


CHART 10



Despite their lowered lending volume, however, associations provided a large amount of additional funds to the mortgage market indirectly through the purchase of mortgage-backed securities, and in the later part of 1982, they significantly increased new mortgage commitments to rates about 45 percent higher than during the summer of 1982. Moreover, thrifts still were the ultimate investors of over 20 percent of new mortgages.

While the industry has been battered by the adverse economic conditions of the past three years, it has survived and, I believe, has emerged from this crisis period in a potentially stronger competitive posture. The dramatic decline in interest rates since last summer already has produced significant improvements in the industry-wide financial condition, and the Garn-St Germain Act and new Bank Board actions to aid savings institutions all combine to provide a much brighter future for thrifts as housing lenders in the immediate term and over the long run.

Due largely to the decline in short-term rates to 8 1/4 percent in the last quarter of 1982, available data suggests that the thrifts' negative spread between costs of funds and yields on assets was largely eliminated by late in 1982 for the industry as a whole. The Bank Board estimates that the costs of funds during December was 10.43 percent. There will clearly be some month to month variation, but if interest rates stay at current levels there should be further declines in the cost of funds. This is because almost half of savings are indexed to short-term interest rates, and these rates are in the 8.0 to 8.5 percent range. By the end of 1983 if interest rates stay at their current levels, the aggregate spread

between the yield on the mortgage portfolio and the costs of funds should be at least 150 basis points. As a result, operating losses of associations during the final six months of 1982 will be roughly $1.5 billion, only about one-half of the loss experienced during the first half of the year. Indeed, assuming that short-term rates remain constant for the next two months, we expect that most associations will regain profitability in the current quarter.

Even should interest rates rise again, however, a number of sweeping reforms have occurred which provide a foundation for a revitalized and aggressive thrift industry competing effectively as a mortgage lender in the deregulated financial markets of the present and the future.

First and most significant, the Garn-St Germain Depository Institutions Act ("Garn-St Germain Act"), enacted October 15, 1982, provided thrifts with the investment flexibility so vital to remedy the prior misstructuring of their assets and liabilities. The positive effect of one of the Act's provisions, authorizing thrifts and banks to offer an account competitive with money market funds, is already evident. Thus, savings and loans' retail deposit inflows increased sharply in December to a record monthly level as a result of the December 14, 1982, authorization of the new Money Market Deposit Account ("MMDA") by the DIDC, pursuant to the Garn-St Germain Act. This account resulted in net new deposit inflows of an estimated positive $10.4 billion, reducing the net savings outflow for savings and loans for 1982 as a whole to about $6.4 billion, compared to the record $25 billion outflow during 1981. The Bank

Board estimates that roughly 20 percent ($7.8 billion) of the total MMDA balances at year-end 1982 represented funds received from external sources, such as the unregulated money market funds.

The Garn-St Germain Act also provides federal thrifts much more latitude in the composition of their asset portfolios. Thus, the Act allows federal associations to engage in purely commercial lending, to offer demand deposit accounts to corporate borrowers, to engage in greatly broadened real estate investment activities, and to exercise greater flexibility in choosing a stock or mutual charter. The Board has acted swiftly within the last few months to adopt proposed and final regulations implementing these statutory authorities.

These long-term survival tools are supplemented by a number of provisions designed to aid thrifts' recovery from the economic crisis, such as the net worth certificate program and additional powers for the FSLIC in arranging interstate and interindustry mergers, and in its receivership role. The Board itself has provided short-run aid through regulatory reform in the area of net worth, such as the lowering of the regulatory net worth requirement and the adoption of a regulation allowing the appraisal value of buildings to count as equity capital.

Given these conditions, I believe there is now an economic, regulatory, and statutory framework for a swift recovery by the thrift industry, and the continuance of its historic role as provider of mortgage credit in this country.

With respect to thrifts' contributions to the housing recovery now underway, I believe there is no basis for the reservations

expressed by some observers that the additional asset powers provided thrifts in the Garn Act will adversely affect their commitment to mortgage lending. Obviously, associations taking advantage of the new powers will not hold mortgages in the same proportion as before. However, there appears to be little likelihood that the new investment authorities in the bill will lead to lower originations or to a mass abandonment by S&Ls of the housing field. Housing is the field thrifts know best, and the tendency to remain in their area of greatest expertise would be reinforced by the existence of truly rate-sensitive mortgage instruments and the continued presence of the favorable bad debt deduction contained in section 593 of the Internal Revenue Code. Finally, due to their ability to develop a more diversified deposit base and a better balanced portfolio, associations may be more aggressive in competing for funds. The lower proportion of housing loans applied to a higher deposit base should thus preserve the commitment to housing. It is also important to emphasize that the comparative advantage of thrifts lies in originating and servicing mortgages, and their role as mortgage bankers will undoubtedly increase.

While I believe that savings and loans will maintain a strong housing commitment, I do not believe it is either prudent or necessary to enforce asset specialization based on the premise that reduced thrift participation in housing finance would unfavorably affect the housing recovery or the probabilities for a sustained recovery.

First, developments over the last fifteen years have led to a greater integration of mortgage and capital markets. This integration prevents mortgage yields from getting out of line with yields on competing securities in investor portfolios. There are a variety of links, or conduits, between mortgage and capital markets, the most important of which are the federal and quasi-federal secondary market agencies. The predominant link for the conventional mortgage market has been the FHLMC Participation Certificate. For FHA/VA loans, the GNMA pass-through has provided the predominant link. FNMA has also provided important links to both markets; as its traditional role in financing FHA/VA mortgages passed to FNMA, it expanded its share of conventional financing. Historically, FNMA provided this link by financing mortgage purchases with debt, although more recently it has begun issuing pass-through securities in the FHLMC/GNMA mold.

An additional factor precluding a long-term shortage of mortgage credit, regardless of the level of thrift participation, is the efficiency of the secondary mortgage market and its links to the primary markets. As borrowers demand more mortgage credit, as evidenced by an increase in mortgage rates, capital markets will supply funds.

FORECLOSURE ISSUES

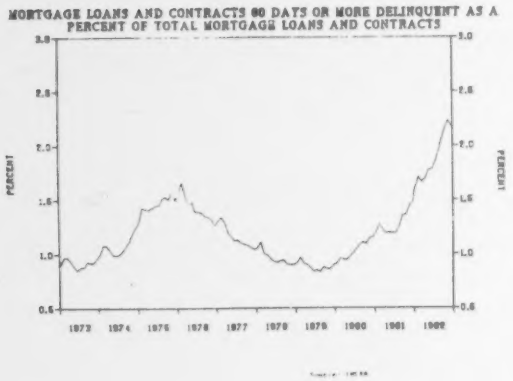
There has recently been heightened Congressional concern that some legislative action is necessary to address the increasing number of delinquent mortgage loans and foreclosures on such loans.

The Bank Board agrees that the economic hardship caused by foreclosures is a matter of concern to associations and borrowers

alike. However, I believe that there are a number of considerations which indicate that any federal intervention at this time would be premature, and could have serious adverse consequences for the thrift industry.

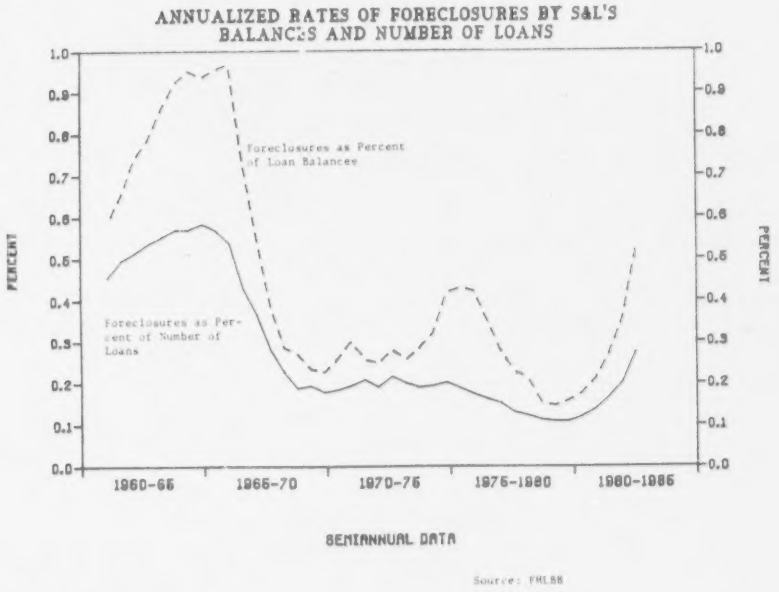
As shown in Charts 11 and 12, our studies show that delinquency and foreclosure rates on loans by FSLIC-insured associations have increased during the last several years. Currently, the ratio of loans 60 days or more delinquent as a percent of total mortgages stands at 2.18 percent, more than double its most recent cyclical low. (See Chart 11).

CHART 11



With respect to foreclosures, the percent of loans foreclosed by FSLIC-insured associations has risen from a cyclical trough in the first half of 1979 of 0.11 percent in terms of number of mortgages and 0.15 percent in terms of mortgage balances, to an annualized rate in the first half of 1982 of 0.27 percent of the number of mortgages and 0.52 percent of mortgage balances. (See Chart 12 for historical view of annualized rates of foreclosures by S&Ls).

CHART 12



Source: FHLBB

The Bank Board agrees that the economic hardship caused by these foreclosure figures is a matter of grave concern. While the annualized rate of foreclosures in first-half 1982 is higher than for that occurring during the recession period 1975-1976, it is much lower than the higher rates sustained during the six-year period extending from second half 1962 through the first half of 1968 (See Chart 12). During that time, there were six semi-annual periods when annualized foreclosures as a percent of mortgage balances approached or exceeded .9 percent, almost double the .524 ratio for the second half of 1982.

Moreover, there are a number of factors indicating that the 1982 foreclosure data are artificially high and reflect factors other than currently high unemployment levels. For many reasons, a rational borrower in 1981 or 1982 may have viewed foreclosure as a much more attractive option than in previous years. Where the loan was made in the late 1970's with a low downpayment, a borrower desiring to sell the property in the last two years encountered substantial disincentives. First, appreciation in existing homes has been flat since July 1981, thereby reducing the borrower's effective equity appreciation. Second, borrowers in many cases could sell a home only by providing substantial discounts through seller-financing due to the extremely high mortgage interest rates prevailing throughout 1980 and 1981. These high rates, reaching a peak of over 17 percent in 1981, also made it quite difficult to obtain refinancing of second trusts and balloon payment loans. Finally, any profit a borrower might realize from a sale would have been reduced by a real estate commission generally around

6 percent. Given all these considerations, a borrower during the last three years may have viewed foreclosure as an option less costly than refinancing or sale of the property.

A second factor mitigating against federal intervention at this time is the evidence that a recovery in both the economy generally and in the housing industry is underway. As our historical data shows, foreclosures increase during periods of economic stress, while a strengthening economy is generally accompanied by declining rates of foreclosure. Therefore, I believe that we can expect to see a significant decline in foreclosures as the recovery underway continues. Federal intervention should only be considered if the upward trend in foreclosures continues despite a strengthened economic situation.

In addition to the Bank Board's general conclusion that federal remedies for foreclosures are premature, the Board has a number of reservations as to the need and efficacy for certain types of relief now under consideration. Specifically, H.R. 1, H.R. 1330, and S. 466 would require the federal financial supervisory agencies to urge regulated lenders to exercise forbearance with regard to delinquent home loans, and to utilize examination procedures or liberalize regulations to avoid penalizing institutions for such forbearance.

The Bank Board believes that such a policy is problematical for several reasons. First, the necessity of such an approach is highly questionable since it is common practice for associations to voluntarily undertake a forbearance policy in times of widespread regional economic distress. While the mortgage contract does confer upon the lender certain rights and remedies in the case of

delinquency and default, it may be in everyone's best interest if the lender shows forbearance in such circumstances. In general, first mortgage lending is among the least risky forms of lending from a credit standpoint. As long as the borrower has significant equity, forbearance or a rescheduling of the debt may make some sense.

Foreclosure imposes significant monetary costs on lenders and significant psychic costs on borrowers. Given the weakness of many housing markets, the long foreclosure period required in many states, and the costs of foreclosures including legal fees, accrued interest, and property taxes, most lenders, I believe, view foreclosure only as a last alternative. Generally, then, an association which resorts to foreclosure does so only after a careful assessment of the likely costs of continued forbearance compared to the likely return on the sale of the property.

These conclusions are supported by data showing that the ratio of actual foreclosures by FSLIC-insured associations in 1981 and 1982 was significantly lower than the ratio of loans 60 days or more delinquent.

In the absence of any evidence of management abuse of discretion in these instances, a legislative or regulatory restriction on lender foreclosures would have detrimental effects far outweighing benefits to borrowers or institutions. Imposing such restrictions on management would be particularly devastating at this time, when the thrift industry is attempting to create a solid foundation for recovery from the economic shocks of the last three years. Moreover, I believe that the public interest is best served by the availability

of the most efficient mortgage credit instruments that respond to the needs of lenders and borrowers. Government action which interferes with the contractual rights of the parties under such instruments introduces uncertainty into the marketplace, resulting in an increased cost of funds and the reduced availability of credit. Such a result is clearly not in the best interest of the public.

The Bank Board also believes that any proposal for tapping FSLIC and FDIC funds to pay interest on non-performing loans could prove extremely damaging to the integrity of the funds, and to public confidence in regulated depositories. During the last two years, both the FDIC and FSLIC funds have coped with severe industry earnings problems by providing historically unprecedented levels of assistance to aid weakened associations. It is therefore highly questionable whether the funds could continue to respond effectively to the industry's need for assistance if they are required to absorb the additional costs contemplated by such a proposal.

With regard to the FSLIC fund, the changes in financial marketplaces, along with the problems in the thrift industry during the last two years, led to substantial industry consolidation in 1981 and 1982, with the Board approving 72 FSLIC-assisted transactions involving disappearing associations with total assets of $42.3 billion. The present value cost of assistance provided in 1982 alone will cost the FSLIC $1.2 billion over the next 5 to 10 years.

While the Bank Board is encouraged by the steady decline of market interest rates in the past year, the challenge presented to

thrift institutions is not over by any means. At the present time, FSLIC has approximately 100 problem associations -- associations which are either insolvent or ineligible for capital assistance -- for which it must find solutions. Moreover, the Board anticipates that, under the Net Worth Certificate program authorized by the Garn-St Germain Act to assist thrifts with net worth of three percent or less, the FSLIC will provide $1.02 billion in cumulative capital assistance in 1983.

Given the extremely heavy workload anticipated by the FSLIC over the next two to three years, tapping the FSLIC funds to pay interest on non-performing loans could represent a serious threat to the solvency of the fund and radically compromise its ability to carry out its historic role of deposit insurance.

SECONDARY MARKET ISSUES

During the next decade, it is vital to ensure that the secondary mortgage market is able to meet the needs of primary lenders following deregulation. This includes FNMA, GNMA, FHLMC and, increasingly, the private secondary market. Because primary mortgage lenders in the new deregulated marketplace will need greater liquidity to match their asset-liability composition, greater efforts must be made in "selling" the concept of mortgage investing to those entities with an advantage in raising long-term liabilities. Without adequate sales outlets in the secondary market, primary lenders will be less willing to maintain a strong commitment to mortgage lending. An expanded and more flexible secondary market will thus ensure that primary lenders continue mortgage originations since they will be able to pass along their interest rate risk and maintain

greater liquidity. In addition, a mature secondary market can moderate regional differentials in mortgage rates and narrow the spreads between mortgage rates and other long-term capital market rates.

The Bank Board supports several changes that will expand the scope and operation of the secondary mortgage market and thereby provide additional liquidity to primary lenders. First, the Bank Board recommends substantial liberalization in the mortgage limits on FHLMC purchases. This limit is now set at $108,300 for single-family homes, and precludes a significant proportion of properties in high-cost areas from qualifying for FHLMC purchase.

The economic rationale for any limit is to prevent concentration in high-ratio loans on such properties. Ideally, then, there should be no statutory limits. The Corporation should have the flexibility to respond to actual market conditions.

Removal of the mortgage limits is also an appropriate response to the removal of similar restrictions for primary market lenders. Currently, savings and loan associations, credit unions, national banks, and many mutual savings banks can originate residential mortgage loans without regard to any dollar ceiling. Lending authority for primary market lenders has recently been deregulated to allow greater flexibility in managing the assets of these institutions. For the same reasons that these changes have been made on the primary market level, similar changes should be made on the secondary market level to ensure continued liquidity for these institutions. Now that thrift institutions have been given greatly expanded powers, the extent to which they remain in mortgage lending

will depend on their ability to sell the loans they originate in the secondary market.

The Bank Board also supports expanded authority for FHLMC to purchase manufactured home loans. Primary market lenders such as savings and loans and mortgage bankers will only be willing to expand their activity in manufactured housing if a secondary market is developed.

Currently, the FHLMC is limited in its purchase of manufactured homes that are considered real property. This is a very small segment of the market, since most manufactured housing is considered personal property under state law. Thus, by removing current obstacles to the development of secondary market programs for these loans, an increased supply of credit will be available for these home purchases. This is a desirable result as manufactured housing represents an affordable housing alternative for moderate-and low-income families who have been priced out of the site-built housing market. Additionally, as the manufactured housing market grows, additional sources of credit will be needed to finance these homes.

A third change regarding FHLMC that the Bank Board supports is a relaxation of the restrictions on FHLMC's purchase of second mortgages. Currently, purchases must be restricted to second mortgages for energy or home-improvement purposes.

Authority for the corporation to purchase second mortgage loans will expand the availability of various alternative mortgage financing tools such as purchase money mortgages. In California, the most frequently listed reason borrowers seek second mortgages is to

make a balloon payment on a two to three year old creative financing loan. With this authority, the FHLMC will be able to expand those mortgage financing options for homebuyers. Such liberalization is also appropriate since, without sufficient sales outlets in the secondary market, lenders will either reduce their second mortgage originations or hold these loans in portfolio, which they are less willing to do than in the past. An expanded secondary market for these loans will allow lenders to pass along their interest rate risk and replenish their supply of funds for new originations.

A second extremely important aspect of promoting the development of a mature secondary market is the removal of regulatory and statutory barriers which now hinder access to capital markets by private mortgage-backed securities issuers and by sellers of whole loans or participations. Currently, Department of Labor regulations implementing ERISA substantially inhibit pension plan investment in mortgage-backed securities. A private ERISA-covered plan may invest only in private MBSs backed by mortgage pools containing first or second mortgages secured by one-four family units.

In addition, eligibility for investment in whole loans and participations is also constrained by the requirement that the loan be eligible, at the time of origination, for sale to GNMA, FNMA, or FHLMC. Given the current ceiling on these loans, pension plans, for example, are thus constrained from investing in loans exceeding the current $108,300 limit for FHLMC loans unless they go through a costly exemption procedure.

The Bank Board also supports administrative or legislative action giving mortgage-backed securities holders tax treatment

equivalent to that afforded competing pooled investment certificate holders, allowing mortgage investments to compete more effectively for funds from the capital market. Currently, conventional MBSs are issued through a grantor trust. This precludes active management of the trust, since any variation from the practice of creating a trust which is fixed at the time of formation and self-liquidating could result in taxation at the pool level as well as to investors. Due to this structure, pension plan investors are subject to a substantial "reinvestment risk" when loans in the pool pay off more quickly than anticipated, and the plan may be forced to reinvest the funds in lower-yielding assets.

The Bank Board also supports the removal of other restraints arising from applicable state statutes, Federal Reserve Board policy, and federal securities and tax laws, which, in conjunction with the reforms discussed above, would allow the development of a taxable mortgage-backed security based on conventional residential loans that would create a more flexible vehicle for lenders, private pension funds, and others. Such an MBS would encourage thrifts, insurance companies, and state housing agencies to become issuers of the instrument, and would provide a much needed supplement to MBSs issued or sold by FNMA, GNMA, and FHLMC.

Finally, S&Ls and other lenders desiring to sell whole loans or participations are restricted in their access to pension plan investment because current administrative interpretations of ERISA may be read to prohibit transactions wherein the S&L "seller" may subsequently service loans sold to a plan. The removal of these restrictions would give mortgage credit greater access to the private capital markets generally.

CONCLUSION

The past two years have been stressful ones for the savings and loan industry. The equity position of most associations has become attenuated, and several hundred associations have disappeared in voluntary or supervisory mergers.

I believe thrifts can look forward to a much brighter future. Savings and loan interest margins have improved, and further improvement is expected. The passage of the Garn-St Germain Depository Institutions Act has given a new life to the industry by giving it the new powers to expand its customer base and to invest in short-term assets. Because of its historic role in providing mortgage credit, I am confident that the thrift industry will retain its role in mortgage originations and that thrifts and other mortgage investors can and will supply enough mortgage credit to accommodate a modest housing recovery.

The one note of caution I have is a very old one, but one that must be repeated. Associations must make much greater strides in balancing the maturity of their assets and liabilities. This can take the form of much greater reliance on adjustable-rate mortgages, comprehensive hedging strategies using financial futures markets, or the increased reliance on short-term assets. These changes are necessary for the savings and loan industry to exist through future cycles so it can continue to play its premier role in the American housing finance industry.

STATEMENT OF RICHARD T. PRATT, CHAIRMAN FEDERAL HOME LOAN BANK BOARD

Mr. PRATT. It's a pleasure, I assure you, based on our experience last night, to be here this morning.

I will summarize this as briefly as possible, and of course, respond to any questions, asking that the full statement be included in the record.

POSITIVE SIGNS OF RECOVERY

There are many signs of recovery in the housing market. Starts in December were 43 percent higher than the October 1981 low, with single-family starts 58 percent higher than those in October 1981. Permits for 5 of the last 6 months have been over the 1 million annual rate. This contrasts sharply to the prior 12-month period, when permits failed to meet the 1 million level.

Another positive indicator is the recovery in new single-family home sales. These sales exceeded the one-half million rate for the last 2 months and the December rate was 54 percent above the September 1981 low.

Finally, the inventory situation has been and continues to be favorable. The inventory of unsold homes has hovered around 250,000 for most of 1982, and based on the December sales rate, as has been stated previously in this hearing, that's about a 5.8 month supply. The inventory situation is such that I believe increased demand housing will stimulate production and the employment that goes along with that.

Completed unsold homes have been under 100,000 units since last February.

These positive indications in housing starts and sales are paralleled by a distinct upward trend in mortgage activity by savings and loan associations. Federal Savings and Loan Insurance Corporation-insured associations in December 1982, closed more than twice as many loans as in December 1981, and they made almost twice as many new commitments.

In every month since August, the associations have closed more loans than in the corresponding month of the previous year. Additionally, the combined November-December closings of 12.9 billion and the commitments of 15.1 billion are quite strong, given the seasonal pattern of closings.

Even with no further improvement of the housing sector, originations in 1983 will be well in excess of their 1981–82 levels. However, the bank board believes that a 60-percent improvement in originations to $80 billion is a reasonable estimate for 1983.

Another factor of importance in the financing of homes and the health of the housing market is the refinancing which has taken place. As you know, during recent years there was much in the way of "creative seller financing" and other stopgap matters to facilitate the sale of homes. As interest rates have come down somewhat, we see financial institutions moving in and providing formal financing, where informal and perhaps burdensome financing may have existed in the past.

Our scenario essentially envisions a modest economic recovery with interest rates remaining at a moderate level or declining

somewhat. In this circumstance, I think it is clear that housing is going to be one of the sectors leading the economy in the recovery, and the outlook for housing is relatively good.

Consensus estimates for housing starts in 1983 are in the 1.4 million range, while existing home sales will probably exceed 3 million units.

Of course, if the economy should recover more rapidly than we expect and interest rates and inflation again increase, which I suppose has some very positive sides to it also, it would certainly be a negative indicator both for thrift institutions and for housing. The thrift institutions in the last 2 years have been through a crisis, and I think 2 years ago were essentially on their deathbed. Major restructuring and reformation has taken place. A great deal of it, I believe, must be credited to this committee and the leadership of Senator Garn and his counterpart in the House, Congressman St Germain. The Garn-St Germain bill which this body passed is certainly the most sweeping legislation to restructure and allow for the success of thrift institutions in providing housing finance and other finance that has occurred in the last 50 years. These changes lay the framework or groundwork for savings and loan associations and other thrift institutions to continue to serve the housing market and to regain some of the strength which they have certainly lost in the last 2 years.

A measure of the impairment of those institutions, I believe, is the fact that the savings and loans' share of net new mortgage debt dropped to just over 20 percent for 1982 from over 60 percent in 1975. In the absence of the Garn-St Germain bill, I believe the savings and loan business and the mutual savings bank business may well have disappeared from the American scene as providers of housing finance.

The fall in rates, of course, has been immensely helpful in solving short-term problems, and as a result of the decrease in rates, we saw for the first time in December 1982 thrift institutions returning to the profitable category.

We expect, if the rates continue at their current level, that this industry will continue to recover during this year and will be able to provide substantial assistance in the housing market. The mandate of this body in deregulating interest rates on savings deposits has caused a tremendous inflow through regulated financial institutions, banks and savings and loan associations. I see these funds as providing profitable opportunities for these insitutions and providing further support for the recovery in housing. The secondary market, of course, has played a major role and will continue to do so.

I am fortunate to be flanked by the two leading people in the United States in the secondary market, and they will discuss that at great length.

FORECLOSURES AND DELINQUENCIES

In looking at the situation of foreclosures and delinquencies which have been alluded to in questions raised by the Senators here, we, of course, follow these with interest and concern. Foreclosures among thrift institutions are at a cyclical high at this time.

They are at about one-half of the level of their historical high since we have been keeping records.

In alluding to the early discussion between Senator Riegle and the Secretary, we do not keep, and to the best of my knowledge, there are not delinquency figures available for the sixties. There are foreclosure rates. The foreclosure rate at the present time for thrift institutions, I believe, is around one-half of 1 percent, and it was very close to 1 percent during the period 1964–67. I think the system works relatively well. Financial institutions do not foreclose, for several reasons. One, of course, is their own compassion and humanity. But looking beyond that, for the most part a foreclosure is not in the lender's economic interest, especially in an area of troubled economic circumstances and high unemployment, because they must deal with that property, find a sale for it and try to recover their loan balance.

I think that financial institutions have shown substantial evidence of working with borrowers who are suffering economic extremes for one reason or another, and that this system is working relatively well.

Should the Senate view the problems in certain areas as being ones which require Federal intervention, I would certainly recommend that the intervention be largely in the form of unrestricted income assistance payments. I do not think there is evidence that the housing market or the financial market is not working. It's simply that these people do not have sufficient income, in order to meet whatever might be their basic necessities and expenditures.

I think we must be very careful in singling out a group of individuals for very deep subsidies and taxing the fellow citizens of our State to provide those subsidies, simply because that person may have chosen to buy a house rather than rent it or some other circumstance. Whatever assistance might be involved in the financing of homeowners should be on a fair and equitable basis.

I would be more than pleased to respond to the panel's questions.

The CHAIRMAN. Thank you, Chairman Pratt.

Mr. Maxwell.

Mr. MAXWELL. Yes, sir, Mr. Chairman. I am pleased to be here today to testify before the committee. I will submit my statement for the record, if I may.

[Complete statement follows:]

STATEMENT OF DAVID O. MAXWELL, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FEDERAL NATIONAL MORTGAGE ASSOCIATION

Mr. Chairman and Members of the Committee, my name is David O. Maxwell. I am Chairman of the Board and Chief Executive Officer of the Federal National Mortgage Association (FNMA).

FNMA is a corporation chartered by the Congress to provide assistance, liquidity and stability to the home mortage market. FNMA operates in the secondary mortgage market, purchasing mortgages from financial institutions such as mortgage bankers, savings and loan associations, and commercial and savings banks. FNMA obtains the money to purchase these mortgages largely through short- and medium-term borrowing in the capital markets.

Today, FNMA holds over $73 billion in mortgages, somewhat over half being FHA and VA mortgages and the remainder, conventional loans. The Charter Act requires FNMA to purchase these mortgages "within the range of market prices" and the FNMA "operations should be fully self-supporting." FNMA receives no financial assistance from the Federal government.

I appreciate this opportunity to testify on the state of the housing markets, and I applaud the Chairman's initiative in calling these hearings.

My statement today will focus on the following: evidence that a recovery in the housing and mortgage markets has been under way for several months; conditions necessary for this recovery to continue; and, the role of the secondary mortgage market in sustaining a long-term recovery and providing a reliable flow of funds for housing.

THE 1982-1983 HOUSING RECOVERY

There is little doubt that the housing market is now in the midst of recovery, primarily due to the recent sharp drop in short and long term interest rates. During the second quarter of 1982—when 3-month Treasury bills were at 12½ percent and 30 year fixed rate mortgages were at 16¾ percent—housing starts were limited to a meager annual pace of 950,000 units. New homes were sold at an annual rate of only 369,000 units. The primary reason for this poor performance was the severe constraint on housing affordability. High mortgage rates, coupled with the depressing effects of the recession on family incomes, meant that in the second quarter of 1982 a typical family had to spend 35 percent of its after-tax income to qualify for a mortgage on a median-priced home. This was slightly higher than the 34 percent "affordability ratio" during 1981 when starts were only 1.06 million units, and more than double the 17 percent ratio common in the 1960's and 1970's.

The easing by the Federal Reserve in July and August of last year was instrumental in reducing that affordability hurdle. Responding to increasing evidence that the July 1 tax cut had not had the desired effect of stimulating the economy—and that partly as a consequence economic and financial strains threatened crises both domestically and abroad—the Fed engineered a series of discount rate cuts and reserve injections that helped rates decline considerably during the second half of the year. By December, 3-month Treasury bills had fallen to 8 percent, while 30-year mortgage commitment rates were down to 13½ percent. FNMA's own cost of raising funds, as high as 17 percent in the summer of 1981 and just below 16 percent in early 1982, fell to as low as 10 percent in late December.

This decline in interest rates lowered the affordability ratio to 31 percent in last year's fourth quarter. In response, new home sales rose to an annual rate of 525,000 units, while housing starts rose to an annual pace of 1.25 million units. This was an improvement, though still historically low. Building permits—an important indicator of future starts—rose to an annual rate of 1.22 million in the fourth quarter, compared with a second quarter 1982 pace of only 917,000.

These rebounds were impressive, but still well below what had come to be considered "normal" annual levels during the 1970's. In that decade, starts averaged 1.77 million units annually, new home sales averaged 655,000 units and building permits averaged 1.56 million. Clearly, the market had a long way to go to improve to these levels.

As long as interest rates remain at current levels (or decline), housing activity will continue to improve this year. A 13 percent 30-year conventional mortgage rate, coupled with our projections of a moderate (3 percent to 5 percent) increase in home prices and 7.5 percent growth in median family income, should result in the affordability ratio falling to 26.5 by the fourth quarter of this year, averaging 27.5 percent for the year as a whole. Our research indicates this should result in an increase in housing starts to an annual rate of about 1.6 million units by late fall or early winter, averaging 1.45 million units for the year. This would be an increase of almost 40 percent from 1981 and 1982 levels.

If housing starts do rise to the 1.6 million unit level next winter, the 1982-83 housing recovery would end up being slightly, but not significantly, weaker than the average postwar recovery.

CONDITIONS NECESSARY FOR CONTINUED RECOVERY

This relatively optimistic outlook, however, carries three important qualifications. First, it is critical that mortgage rates average close to 13 percent, or lower, for the year. Should mortgage rates average even one percentage point higher, or 14 percent, our housing forecast would show a peak rate of only 1.4 million units, and an annual average of less than 1.3 million units. Second, further improvements above the 1.6 million unit level in 1984 and beyond do not appear likely unless the Treasury's borrowing needs are substantially reduced in those years, thus paving the way for long-term interest rates to decline further. Third, reliable financing from secondary market sources must be made available to the primary mortgage market.

To achieve average mortgage rates around 13 percent this year would require average 30-year Treasury rates of approximately 10¼ percent to 10½ percent. Long Treasury rates did drop to that range early last month, but have risen since. The primary reasons for this rise seem to be investors' concerns about how the market can absorb the Treasury's prospective financings and a general perception that, with the economy showing increasing signs of recovery, the Federal Reserve is less likely to push down short rates in the near future for fear of re-igniting inflation.

We do not share these apprehensions. We believe that both long and short rates will move lower this year—despite the Treasury's borrowing needs—because of low inflation, sluggish private credit demands, the steep climb to get out of the deep recession in which we have been mired, and, conclusively, the political, social, and economic unacceptability of higher interest rates—which would kill the infant recovery in its cradle. Consequently, we expect the housing rebound to remain on track through 1983.

Beyond 1983, the forecast is more clouded. If Treasury's financings remain about $200 billion per year or more and private needs for credit gain momentum with recovery, it is hard to imagine long-term rates falling below 1983 projected levels. This would make maintaining housing starts of 1.6 million units at 13 percent mortgage rates a formidable challenge.

In our judgment, it will be difficult to have a lasting recovery in the housing market unless "out year" structural budget deficits are reduced substantially. Absent such reduction, housing may be crowded out of the credit arena long before pent-up demand can be satisfied.

INCREASING IMPORTANCE OF THE SECONDARY MARKET

An indispensable requisite for a continued housing recovery is a reliable flow of funds from the secondary market. As traditional intermediaries such as thrifts and banks experience higher average costs and shorter average maturities on their retail deposits because of interest rate deregulation, long-term mortgage lending will likely seem less and less attractive as an outlet for those funds. To a lesser extent, recently broadened asset powers for thrift institutions may diminish these lenders' support of the residential mortgage market over time as they develop their non-housing real estate and other powers. These factors will require secondary market investors to play an increasingly greater role in mortgage finance if affordable capital is to remain available for housing.

The question is what can and must be done to restructure the secondary market to assure that it plays this role as efficiently and effectively as possible.

Congress has served the nation well by developing the federally sponsored institutions in today's secondary market. During the past decade of explosive growth in home ownership—punctuated by credit crunches—FNMA, FHLMC and GNMA provided substantial liquidity to the home mortgage market. In doing so, they supplemented the mortgage investments of thrift institutions whose activity was also largely limited to home finance.

Now, the rules of the game have changed. A mortgage credit "gap" will develop because depository institutions, especially thrifts, will not be willing to make long-term investments with short-term money, such as the new insured money fund accounts. Moreover, with new asset powers, they will want to maintain greater liquidity. Hence, we expect far more money will be needed from the secondary market to finance the housing needs of Americans. There is no way FNMA, GNMA, and FHLMC by themselves can close the mortgage credit gap. Nor should they be the sole vehicles to do the job.

To provide the additional horsepower needed in the secondary market, deregulation of the primary market must be followed by restructuring of the secondary market. Only then can the secondary market keep pace with the many changes in the way financial institutions do business.

This is especially true for FNMA, which serves the primary housing market both as a portfolio lender and as a conduit through the use of mortgage-backed securities. When Congress in 1968 divided FNMA, setting up GNMA within the government and moving FNMA into the private sector, few could foresee the economic turmoil in store for financial institutions at the end of the decade. The framers of the FNMA Charter Act had every reason to believe the "agency" attributes bestowed upon the newly private company would more than suffice to enable it to remain self-supporting and to raise capital in the private market to support its mortgage-purchase activities. Indeed, it must have seemed then that the corporation's continued ability to borrow at favorable rates after it left the government would ensure its future prosperity in any conceivable economic circumstances. So it is not surprising

that the company's modus operandi did not change materially in its transition from partial government ownership to full private ownership. Optional delivery commitments at fixe' .nterest rates made FNMA a true lender of last resort—and at rock-bottom fees . its services.

FNMA's ordeal of the last few years has uncovered basic flaws in its structure and has proved beyond contradiction that it must be run like any other for-profit, taxpaying company if it is to survive and carry out its mission. The dedication of our board and our management to that objective has stabilized the company's financial condition and given the housing market unprecedented support in the last 18 months. During 1982 alone, FNMA purchased a record volume of $15 billion in home loans in addition to placing $15 billion of such loans in its new conventional mortgage-backed securities program. As part of the latter effort, we "swapped" $12.9 billion of securities for portfolio loans of thrift institutions, giving them added liquidity when they needed it most.

Without FNMA, a bad housing year would have been a disaster. Without FNMA, many builders and some lenders tell me they would not be in business today. Because w' provided a market for an extraordinary variety of adjustable rate loans, buy-downs, and other instruments, builders were able to move their inventory in local markets and lenders could earn origination and servicing fees.

At the same time, it must be said candidly that FNMA itself came close to not being able to support the mortgage market at those, or any other, levels. Because we have weathered the storm and emerged a stronger company, I can tell it "like it was" without risk of precipitating the avalanche that would have thundred down on the U.S. economy if investors had lost faith in FNMA.

I became Chairman of the Board and CEO of FNMA in May, 1981. In the third and fourth quarters of that year, FNMA lost $150 million after taxes—$79 million in the third quarter and $70 million in the fourth quarter. At the end of 1981, FNMA was losing money at the rate of more than one million dol'ars per business day.

To cauterize this wound, our new management team instituted mandatory deliveries, launched ARMs, started our mortgage-backed securities program (for which HUD gave us speedy approval), and realigned our fees. Without these and other badly needed changes, the losses in the third and fourth quarters would have continued into 1982. Our losses in the first half of that year would have far exceeded the actual $86 million. Our retained earnings, which had already declined from a high of $877 million in early 1980 to $604 million at the end of 1981, would have eroded to the point where even the lower money market rates of the second half of 1982 would not have helped to bolster investors' confidence in the company, especially since, if FNMA were still doing business as it did as recently as 1980, we would not have received delivery of loans needed to raise the yield on our portfolio. This is because, under optional delivery commitments, lenders could have received a better price for these loans from other buyers in a declining interest rate environment. Under these circumstances, even if the market would have allowed FNMA to borrow, the rates charged would have been prohibitive, contributing further to our losses, leading in turn to still higher rates—a true snowball of catastrophe.

It didn't happen. The snowball never got rolling. Without any federal bailout or special assistance,[1] we turned the company around—even before interest rates fell. We lifted ourselves up from a very deep hole.

Now, it must be said that we are not completely out of that hole. FNMA remains vulnerable to a sudden and sustained increase in interest rates. We still own an enormous portfolio of low-yielding loans—$37 billion of our total portfolio of $73 billion yields 10 percent or less. As a result, we sufer a negative spread on our portfolio. The life of our debt is much shorter than the life of our assets.

Unlike the old FNMA, however, the new FNMA is planning strategies to cope with this mismatch. We do not want to subject ourselves to the same crushing experience we have just been through. Not only must FNMA be a sound investme.' for creditors and stockholders, but it must be able to support the houding industry _ d mortgage market, particularly when times are bad, as they were in 1982. To do that, we must reduce to the greatest extent possible our vulnerability not only to economic storms but to the vagaries of political winds.

Thus, now that we have succeeded in turning the company around, we must shift our attention to FNMA's long-term growth and stability. This requires a number of

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[1] In 1982, the Congress amended FNMA's tax-loss carryback and carryforward to conform substantially to that of other financial institutions. This resulted in a small pickup of earnings in 1982 and a cash refund in 1983 of taxes previously paid. Unlike FHLMC, FNMA pays federal income taxes at the full corporate rate and looks forward to resuming paying these taxes soon.

structural changes in the way FNMA and the rest of the secondary mortgage market operate. Let me briefly highlight those changes, because they will be necessary to sustain the expected recovery in the housing market—a recovery which can in turn provide jobs for Americans and contribute mightily to the restoration of our country's economic health.

As it was necessary to give primary portfolio lenders diversified asset powers to ensure their financial stability and their ability to continue to finance housing, so it is essential for investors in the secondary market, including FNMA, to possess the flexibility to respond to the demands of the primary market quickly and effectively. Such flexibility would enable FNMA to meet the needs of the housing market throughout the housing cycle, as well as contribute to job creation and the economy's health.

First and foremost, FNMA's long-term ability to serve housing requires priority attention to the asset side of our operations. Above all, there must be no repetition of the mistake of deregulating liabilities before assets which was so devastating to the thrift industry.

FNMA's ability to serve the entire mortgage market would be strengthened if the mortgage loan limits in our Charter Act were deleted. Consumers of mortgage funds must compete with other users of capital. Our capacity to borrow additional debt to fund our purchase of loans on moderately priced housing will be enhanced by our ability to purchase loans across the spectrum of the market. Moreover, in some areas of the country, our current mortgage limit of $108,300 shuts us out of even the median-priced housing market.

A separate but related issue is the matter of HUD's regulatory power over FNMA operations. Even at its best, the cumbersome nature of the regulatory process has meant costly and unnecessary delay in bringing to market products of great benefit to consumers. While general oversight by the Congress and by the Secretaries of the Treasury and HUD is an understandable facet of FNMA's status as a congressionally chartered private enterprise, the corporation must be able to serve the housing and real estate markets without spending lengthy periods of time in the regulatory labyrinth justifying the detailes of its products, either on the asset or the liability side of its balance sheet. Like federally chartered banks and thrifts, FNMA needs both to plan business strategies for years ahead, especially given the historic cyclicality in the housing market, and to respond to short-term market developments. That is almost impossible under the current regulatory structure and jeopardizes not only the financial viability of FNMA, but our sustained capacity to support housing, as we did in 1982. We have no wish to alter FNMA's basic mission, nor will we.

Other secondary market institutions may need comparable structural change to meet the housing and real estate needs of the 1980's. Indeed, we may want to look back to the National Housing Act of 1934 and its concept of national mortgage associations which were intended to be private for-profit corporations, under government oversight, that would serve the secondary market. As it happended—I suspect because of excessive restrictions in the 1934 Act—none of these private natonal mortgage associations actually was established. Instead, FNMA was created in 1938 as a subsidiary of the Reconstruction Finance Corporation and was brought into private status only 30 years later. But that concept of a secondary market consisting of private enterprises, some congressionally chartered and others not, is worth further consideration.

We believe housing will need more capital, not less, in the decades to come. This Committee will thus bear a heavy responsibility to stand up for housing's needs and to maintain our nation's proud and vital tradition of homeownership. FNMA will do everything in its power to help.

May I conclude by again thanking you, Mr. Chairman, for the opportunity to present these views on the state of the housing markets and the secondary mortgage market. I would be pleased to answer any questions you or your colleagues might want to ask.

STATEMENT OF DAVID O. MAXWELL, CHAIRMAN & CHIEF EXECUTIVE OFFICER, FEDERAL NATIONAL MORTGAGE ASSOCIATION

Mr. MAXWELL. FNMA is a private stockholder-owned corporation, chartered by the Congress to provide a secondary market for mortgages.

At the present time, we own $73 billion in mortgages, which is about one in every 20 in the United States, and we receive no Federal assistance.

I subscribe to the outlook stated by Chairman Pratt for housing in the near term, and therefore, do not think it is necessary for me to repeat what he said.

REQUIREMENTS FOR RECOVERY

I believe housing starts will rise to about the 1.6 million unit level this winter, and if that happens, the housing recovery would end up being slightly but not significantly weaker than the average post-war recovery. This relatively optimistic outlook, however, carries three important qualifications. First, it is critical that mortgage rates average close to 13 percent or lower for the year. Should they average even 1 percent higher, 14 percent, our housing forecast would show a peak rate of only 1.4 million units, an annual average of less than 1.3 million units.

Second, further improvement above the 1.6 million unit level in 1984 and beyond does not appear likely unless the Treasury's borrowing is substantially reduced in those years, thus paving the way for long-term interest rates to decline further.

Third, reliable financing in secondary market sources must be made available to the primary mortgage market.

We believe both long- and short-term rates will move lower this year, despite the Treasury's borrowing needs, because of low inflation, sluggish private credit demands, the steep climb to get out of the deep recession in which we have been mired, and conclusively, the political, social and economic unacceptability of higher rates, which would kill the infant recovery in its cradle.

Consequently, we expect to have the rebound remain on track through 1983. Beyond 1983, the forecast is more clouded. If Treasury's financing is to remain $200 billion per year or more and private needs for credit gain momentum with recovery, it's hard to imagine long-term rates falling below 1983 projected levels.

This would make maintaining housing starts at 1.6 million units at 13-percent mortgage rates a formidable challenge.

In our judgment, it will be difficult to have a lasting recovery in the housing market unless out-year structural budget deficits are reduced substantially. Absent such reduction, housing may be crowded out of the credit arena, long before pent-up demand can be satisfied.

An indispensable requirement for recovery of the housing market is, of course, a reliable secondary market. This is particularly true because the rules of the game have changed, as Chairman Pratt alluded to in discussing the accomplishments of the Garn-St Germain bill. But this has, of course, given the thrifts a lot of short-term deposits, on which they may be unwilling to make long-term investments. They also gain some new asset powers, which will lead them to maintain greater liquidity. So, we expect far more money will be needed for the secondary market to finance the housing needs of Americans.

We believe there is no way that FNMA, FHLMC and GNMA can supply all of this money, nor do we think they should.

To provide the additional horsepower needed in the secondary market, deregulation of the primary market must be followed by restructuring of the secondary market. Only then can the secondary market keep pace with the many changes in the way financial institutions do business.

ROLE OF FNMA

This is especially true for FNMA, which serves the primary housing market both as a portfolio lender and as a conduit through the use of mortgage-backed securities.

When Congress in 1968 divided FNMA, setting up GNMA within the Government, and moving FNMA into the private sector, few could foresee the economic turmoil in store for financial institutions at the end of the decade. The framers, in defending their charter, had every reason to believe the "agency" attributes bestowed upon the new private company would more than suffice to enable it to remain self-supporting and to raise capital in the private market to support its mortgage purchase activities which, incidentally, our charter requires us to do.

Indeed, it must have seemed then that the corporation's continued ability to borrow at favorable rates after it left the Government would insure its future prosperity in any conceivable economic circumstances.

FNMA's ordeal during the last few years has uncovered basic flaws in its structure, and it has proved beyond contradiction that it must be run like any other for-profit, tax-paying company, if it is to survive and carry out its mission.

The dedication of our board and management to that objective has stabilized the company's financial condition and given the housing market unprecedented support in the last 13 months.

During 1982 alone, FNMA purchased a record volume of $15 billion in home loans, in addition to placing $15 billion of such loans in its new conventional mortgage-backed securities program.

As part of the latter effort, we swapped $12.9 billion of securities for portfolio loans at thrift institutions, giving them added liquidity when they needed it most.

Without FNMA, a bad housing year would have been a disaster. Without FNMA, many builders and some lenders tell me they would not be in business today. Because we have provided a market for an extraordinary variety of adjustable rate loans, buydowns, and other instruments, builders were able to move their inventory in local markets and lenders could earn origination and servicing fees.

At the same time, it must be said candidly that FNMA came close to not being able to support the mortgage market at those or any other levels. Because we have weathered the storm and emerged a stronger company, I can tell it "like it was" without risk of precipitating the avalanche that would have thundered down on the U.S. economy, if investors had lost faith in FNMA.

FNMA suffered losses in the the third and fourth quarters of 1981 which totaled $150 million, and the management that came in in the middle of 1981 instituted a number of programs to try to reverse this trend. Without this, our losses in the first half of 1982

would have far exceeded the actual $86 million. And our retained earnings, which had already declined from a high of $877 million in early 1980 to $604 million at the end of 1981, would have eroded to the point where even the lower money market rates for the second half of 1982 would not have helped to bolster investors confidence in the company.

Well, this didn't happen. The snowball never got rolling. The higher rates that we had to pay for our money that led to higher losses and higher rates in turn never got rolling.

Without any Federal bailout or special assistance, we turned the company around—even before interest rates fell.

Now it must be said that we are not completely out of the woods. FNMA remains vulnerable to a sudden and sustained increase in interest rates. We still own an enormous portfolio of low-yielding loans, $37 billion of our total portfolio of $73 billion yields 10 percent or less. As a result, we suffer a negative spread on our portfolio. The life of our debt is much shorter than the life of our assets.

Unlike the old FNMA, however, the new FNMA is planning strategies to cope with this mismatch. We do not want to subject ourselves to the same crushing experience we have just been through.

LOOKING AHEAD

And I must say I support something that Senator Riegle mentioned, when he spoke with the Secretary about the necessity for planning over a 5-year span, to look ahead, to develop strategies to cope with the housing market and the needs of the secondary market as they will be during that time.

That's what FNMA needs to do. We must reduce to the greatest extent possible our vulnerability not only to economic storms but to the vagaries of political winds.

We have succeeded in turning the company around. Now we shift our attention to FNMA's long-term growth and stability. This requires a number of structural changes in the way FNMA and the rest of the secondary mortgage market operate.

I understand, Mr. Chairman, it is your intention to hold hearings on the subject of the secondary market in the relatively near future, so I will not go into detail about the changes that I think are necessary, but we will be coming to the committee and to you, Mr. Chairman, with some proposals for legislative changes that we believe will strengthen the secondary market which will be so vital to maintain the housing recovery which has begun.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Maxwell.

Mr. Thygerson.

Mr. THYGERSON. Good morning, Mr. Chairman, members of the committee.

[The complete statement follows:]

Statement of Kenneth J. Thygerson, President of the Federal Home Loan Mortgage Corporation

I. OVERVIEW

Good morning Mr. Chairman and members of the Committee. It is a pleasure to be here today to address the status of the housing recovery and what actions Freddie Mac is taking to assist the delivery of mortgage credit at affordable interest rates to homebuyers.

In my comments today, I would like to focus on two issues. First, whether the housing recovery which is underway is real and can be sustained. And second, whether the housing finance system has the capacity to deliver the volume of mortgage credit that will be needed, at competitive rates. My answer to both questions is generally yes, although there are a few qualifications.

The strength of the housing recovery is fundamentally dependent on the level of interest rates. It can be sustained as long as the financial market environment is conductive to steady, or declining interest rates. As a result of the links provided by the secondary mortgage market—which I shall discuss in more detail later—capital market rates are translated into home mortgage rates. As they have fallen in recent months, the quantity of mortgage credit demanded has risen, reflecting purchases of new and existing houses, and refinancing of higher rate mortgages and those with balloon payments that are due. Demographic forces have also increased the demand for morgage credit—but the most important dimension in sustaining the recovery is stable or slightly declining interest rates.

At the same time, changes in who originates mortgages in the primary market will continue. For example, thrift institutions (savings and loan associations and mutual savings banks) will continue to play an important role in mortgage originations—but it will be less than their historic high shares of the mid- to late-1970s. As a result, housing finance will increasingly depend on both nontraditional originators and nontraditional sources of funds. And the key to this transition will be the secondary market.

The question arises, can the secondary market accommodate the needs of a wide range of borrowers, lenders, and investors, and handle the increased volume of mortgage credit that we expect. All current indications are that it can—as illustrated by recent innovations at Freddie Mac and Fannie Mae, and the emergence of new actors in the marketplace. In addition, some legal changes and further creativity may be necessary for the secondary market to achieve its full potential, but overall I believe that the housing finance system will have the capacity to meet the mortgage credit needs of the 1980s.

With this in mind, I will discuss three topics: first, recent trends in housing activity and housing finance; second, the key role of secondary markets in the housing recovery; and third, some recent innovations at Freddie Mac which we have made to improve the delivery system for mortgage credit and to assist the housing recovery.

II. RECENT TRENDS IN HOUSING ACTIVITY

1982 was the fourth consecutive year of decline in the nation's new housing activity, and the worst for the housing sector on record for the post-World War II period. Total private housing starts amounted to 1.06 million units, the smallest for any year since 1947. Sales of new single-family homes were the poorest in the last twenty years. Existing home sales fell below 2 million units for the first time since 1970.

However, against this negative backdrop, recent trends give much cause for optimism. Hidden behind these annual measures is a strong resurgence of activity in the housing sector during the second half of 1982. Total housing starts climbed 27 percent to an annual rate of 1.19 million units in the second half of the year, from only 936,000 units in the first half. New construction of single-family homes in the second half surpassed the first half amount by 20 percent. (Exhibit 1 shows the trends in housing starts since 1980—and the changes in mortgage interest rates which are driving them.)

Despite a modest decline in December, the number of houses sold in that month, at a seasonally adjusted rate, was 46 percent higher than in July. Activity in the home resale market has also revived, though less vigorously. By November, however, sales of existing homes crossed over the 2 million mark to reach their highest level in more than a year.

With the dramatic improvement in new home sales, builders' inventories of unsold houses declined significantly, both in absolute terms and in relation to the current selling rate. As of December 1982, it takes a builder an average of 5.8

months to sell a house once it is put on the market, compared with 9.5 months in April 1982, and nearly a full year in September of 1981. A new mood of optimism pervades the home construction markets.

The consensus of opinion is that housing starts for 1983 will be between 1.3 and 1.5 million units. Although this is not an especially large number by historical standards, it represents a 40 percent increase from 1982 starts.

Further, housing demand is expected to rise significantly over the next decade, even under moderate assumptions about economic growth and interest rate declines. In large part, this will be due to demographic changes, most notably the maturation of the baby boom. These forces will produce a continued increase in the types of households demanding single-family owner-occupied housing, both new and existing. In other words, the current housing recovery has far to go before exhausting the potential demand at affordable rates.

The economic recovery which now appears to be underway will owe a large debt to the housing sector. A rebound of home construction activity from severely depressed levels will begin to lift employment in the building trades and in industries that feed into housing production. In turn, rising employment in these sectors will create income to be spent on a wide range of goods and services. As the process continues, this will help support a more broadly based recovery in industrial output and jobs, and an accelerating growth of real GNP.

III. HOUSING FINANCE

The driving force behind the current housing revival has been the declining cost of financing home purchases. Market rates of interest soared to record peaks in mid- to late-1981 and declined only modestly throughout the first half of 1982. By mid-1982, however, Federal Reserve Policy seemed to shift from monetary stringency to accommodation. The discount rate was lowered seven times over the latter half of 1982, from 12 percent to 8.5 percent. Market rates responded sharply. Between June and December, yields on U.S. Treasury debt fell about 500 basis points for one-year maturities and 340 basis points on 30-year issues.

The interest rate on prime conventional fixed-rate loans to homebuyers also declined. As measured by Freddie Mac's weekly survey of primary lenders, conventional mortgage rates fell 335 basis points, from the early July peak of 16.93 percent to the year end level of 13.57 percent. Despite a recent backup of market interest rates, reflecting heightened investor awareness of the large federal deficits to be financed over the next several years, the primary market mortgage rate declined further to a U.S. average of 13.06 percent as of February 4. Conventional 30 years fixed-rate mortgages are now available in the 12½ percent to 13½ percent range from many lenders. As rates have fallen, this mortgage instrument has experienced a resurgence in popularity.

The source of the drop in mortgage lending rates occurring over the last seven months has not been a surge of saving inflows to thrift institutions in a declining interest rate environment, as in the historical pattern. Rather, mortgage rates have come down directly as a result of the decline in capital market yields. The secondary mortgage market is the mechanism by which investor funds are transferred to mortgage lenders and capital market yield trends are translated into mortgage rate trends.

Recent activity data of Freddie Mac, the largest purchaser of conventional mortgages, demonstrate the key role of the secondary market in the decline in interest rates to homebuyers since mid-1982. From June to December, the yield at which investors purchased the corporation's mortgage-backed securities, called PCs for Participation Certificates, fell 350 basis points, closely in line with the decline in other capital market rates. A further modest decline occurred in January. Because we could sell participations in mortgage pools at lower rates, we were able to reduce the yield at which we purchased mortgages from lenders by an almost identical amount. The drop in our purchase yield enabled lenders to originate loans at progressively lower rates to consumers.

The extent to which lenders took advantage of declining capital market yields is illustrated by the following figures. In the first nine months of 1982, the yields at Freddie Mac's weekly auctions averaged over 16 percent. At these yields, we purchased only about $1 billion in new mortgages. By the last three months of the year, our yields had dropped to an average of 13⅓ percent—and our commitment volume soared to $1.8 billion, nearly double the amount for January through September. On an annual basis, this would be over $7 billion, and closer to $8 billion using our volume for January 1983.

In addition to our purchases of new production loans in 1982, we handled a large volume of our Guarantor program—over $25 billion. In this program, mortagages are "swapped" for Freddie Mac PCs, which can be held, sold, or borrowed against. This satisfied the need of lenders—primarily thrift institutions—for more liquid portfolios.

Some have questioned the extent to which secondary market purchases of new loans on existing housing, especially those originated to refinance existing loans at lower rates, and purchases of old loans in thrift portfolios, contribute to the housing recovery. In my view, they have been as important to the current housing recovery as the purchase of newly originated loans to finance recently constructed houses. Let me explain.

The refinancing of existing loans has increased at an accelerated rate. These loans were mostly originated at extremely high interest rates, by historical standards. Many involved creative financing, including balloon payment loans. These loans reflected the response of the housing finance sector to extremely difficult and unusual times, and are fraught with risks. It is vitally important to the general health of the housing sector to restructure this debt on a sounder footing.

Financing of existing housing is equally important to the current housing recovery. Rising sales of existing homes are a prerequisite to a strong recovery of new home construction, because they provide the necessary funds for consumers to upgrade to higher priced new homes. Most purchasers of new homes are not first time buyers, and therefore must sell an existing home before getting into the new home market.

The SWAP program has also proved extremely beneficial to the housing sector, and has helped establish a firmer base for the housing recovery in several ways. First, it has provided needed liquidity to the thrifts, improving their ability to assist in this recovery as they have in past recoveries. Second, many of these pools have been sold to nontraditional lenders, providing an infusion of fresh cash into savings and loans that is available for new home loans.

We think much of this refinancing activity is necessary, but transitional. As the mortgage market digests the after-effects of this recent period of volatility, activity will settle into more traditional patterns. In this regard, our future activities will focus on loans for newly purchased houses.

The conclusion of our analysis of recent trends in housing activity and housing finance is that the housing recovery is underway, by and large a result of improvements in the financial sector. Put simply, homebuyers are moving back into the housing market because mortgage rates have dropped below the "affordability threshold." The demand to sustain the recovery is there. As a result, special programs for government stimulus, which have sometimes been tried in the past, are not required, and in fact, if implemented could provide more stimulus at the peak than at the trough of his housing cycle.

IV. THE HOUSING RECOVERY AND SECONDAY MORTGAGE MARKETS

Given the dramatic increase in mortgage credit needs, the question arises as to how this mortgage credit will be provided. We are seeing, and will continue to see, changes in both primary and secondary markets as they seek to respond to the mortgage credit demands of the 80s. In general, I am confident that not only will the housing finance system have the capacity to meet these demands, but it will be able to meet them in a more flexible and efficient environment.

Primary market

In the past, the bulk of mortgage credit was originated and financed by thrift institutions. They originated over one-half of all one-to-four family mortgages in the 70s, and close to two-thirds of the conventional activity. This share has been falling in recent years, however. New lenders have been emerging. The mortgage bankers' share of originations has increased significantly, while commercial banks have continued to average over 20 percent of total originations. (See Exhibit 2.) In addition, finance companies, credit unions, credit corporations, and others are beginning to originate mortgages in the primary market.

I want to point out that the decline in thrifts' mortgage origination activity should not be overplayed. Thrifts' expertise in originating and underwriting mortgages insures that they will continue to play an important role in the supply of mortgage credit. At the same time, thrifts have gained significant flexibility in the types of mortgage instruments they can originate. However, development of the secondary market allows their origination activity to be independent of their ability to

finance the mortgages. Thrifts will increasingly take on mortgage banking functions.

The shift in the role of thrift institutions is a result of continued, and I might add needed, broadened asset and liability powers for thrifts. As thrifts use this flexibility to diversify their portfolios and become more liquid, the share of assets they invest in mortgages will decline. hence, housing finance must increase its reliance on nontraditional originators, and on nontraditional sources of funds as well.

Secondary market

The decrease in deposit financing of home mortgage credit by thrifts, coupled with the increased mortgage demands of the 1980s, presents a challenge to the secondary market. In the past, the role of the secondary market was primarily to move funds from capital surplus areas to capital deficit areas. For example, thrifts in surplus areas, such as the Northeast, purchased PCs backed by mortgages originated in deficit areas, such as California. The secondary market also helped broaden the market for home mortgages by creating securities which are demanded by nontraditional lenders. Freddie Mac and Ginnie Mae have been the leaders in the conventional and government mortgage markets, respectively. The challenge of its future role is considerably broader. In the 1980s, the secondary market must provide the mortgage market as a whole with a supply of funds from capital markets, and thus increase the net supply of mortgage credit. This will mean a significant increase in the volume of mortgage credit flowing through the secondary market. The question arises, can it accommodate this volume?

I am confident that the secondary market will be successful in meeting the volume requirements of the 1980s. Indeed, the secondary market has already begun to respond. Projections of secondary market activity, as measured by gross sales of FHA/VA and conventional mortgages in the first six months of 1982, show a dramatic increase from 1981 activity. Excluding Freddie Mac and Fannie Mae SWAPs, loan sales in 1982 will, in all likelihood, increase by close to 75 percent, reaching the highest level in the past decade. (See Exhibit 3.)

Secondary markets will meet the volume needs of the 80s because they are able to change daily in response to the needs of the marketplace. For example, in addition to the capacities of Freddie Mac, Ginnie Mae, and Fannie Mae, other actors are emerging, especially in the conventional secondary market. This market has tremendous potential, which can be shown in the ratio of mortgages purchased by pools to originations. In the first nine months of 1982, this ratio was over 80 percent for FHA/VA loans. The comparable number for conventional mortgages (excluding SWAPs) was only 5.4 percent. (See Exhibit 4.) The recent creation of the Residential Funding Corporation and the increasing role of Salomon Brothers as a mortgage broker, are a response to this potential.

To achieve the full potential of the secondary market, some legal changes will have to be made. For example, in order to expand the capacity of conventional mortgage-backed securities, enhancements should be made in the ability of secondary market conduits to manage the pools of mortgages. This would increase the possibilities for structuring innovative instruments that appeal to varied groups of investors. An example of this is the exemption from grantor trust restrictions as contained in the TIMs proposal. At Freddie Mac, we are enthusiastic about using this authority if it is made available to the market.

Further, it is not enough that the sheer volume of mortgage credit demand be met. This supply must be in a form that allows appropriate flexibility to both lenders and borrowers in structuring mortgage instruments to meet their needs. At the same time, efficient delivery systems must develop that allow borrowers and investors to match these needs, and efficiency and standardization go hand in hand.

This involves a trade-off between offering a wide variety of mortgage instruments and offering the lowest possible interest rates. To obtain the best possible rates for homebuyers in capital markets, a threshold volume of mortgages must be traded. With the variety of mortgage instruments in the market (some put the number at over 100), this threshold volume is not reached except for a few instruments such as the 30 year fixed-rate loan.

To summarize, the secondary mortgage market will play a critical role in meeting the mortgage credit demands of the 80s. It is well positioned to do so, and I see few problems in its ability to provide the needed volume of mortgage credit at the best possible rates. One element is crucial, however, and that is the standardization of mortgage instruments so that homebuyers may benefit from the close link between capital and secondary market rates. The advantage of such a link is evidenced by the difference in mortgage rates between the types of mortgages that can be financed in secondary markets via Freddie Mac, Fannie Mae, and Ginnie Mae, and

those which cannot. These mortgages require premiums on their yields because their access to secondary markets is limited. High balance loans, conventional GPMs, and second mortgages are just a few examples. Moreover, these restrictions may limit the housing recovery. For example, a recent (February 2, 1983) *Wall Street Journal* article shows how this issue is tied to the housing recovery. It states:

"Mid-priced homes—those roughly in the $50,000 to $100,000 range—seem to be selling most quickly. That's partly because sales of more expensive homes requiring mortgages greater than $108,000 are being hobbled by the fact that there's no secondary market where lenders can sell these large loans, and most lenders are reluctant to lock themselves into loans that can't be resold."

V. RESPONSIVENESS AND INNOVATION AT FREDDIE MAC

My conclusions to this point have concerned the role of the secondary market generally in meeting the mortgage credit needs of the 1980s, and sustaining the housing recovery. I have touched on who the lenders in the primary market will be, how important the secondary market will be, and the need for standardized mortgage instruments to suit the needs of all the participants in these markets. I would now like to turn to recent innovations in the way that we do business at Freddie Mac, in terms of each of these areas. As you will notice, our emphasis in 1983 will be on expanding the secondary market for new mortgage originations, although we will continue to improve our Guarantor program to assist lenders in meeting their needs for increased liquidity.

Primary market

The ability of a wide variety of mortgage lenders to participate in the delivery of mortgage credit will depend on their access to the secondary market. We are therefore eager to expand our customer base, and are reducing barriers to make it easier for all lenders to participate in our programs. Let me illustrate this by listing some of the steps we have already taken to achieve this goal.

On November 1, 1982, Freddie Mac dropped the 50 basic point fee charged to nonmembers of the Federal Home Loan Bank System. This change increases access to the secondary market for conventional mortgages for commercial banks and mortgage bankers. Although historically thought of as FHA/VA originators, mortgage bankers increased their share of conventional originations to 17 percent for the first nine months of 1982. Commercial banks continued to originate about one-fourth of conventional loans. In addition, the change opens the door for emerging mortgage lenders such as credit unions and credit companies.

Last November we began allowing million dollar SWAPs in our Guarantor program. This is the second reduction from the $10 million requirement when the program began in 1981.

Just last week I announced another change to the Guarantor program. For the first time, we will swap certain fixed-rate, FHA-insured and VA-guaranteed loans, as long as they are at least one year old loans on single-family homes.

Further, we have simplified our seller/servicer application process, abolishing application fees and reducing paperwork.

Secondary market

While we have made many changes to promote access to the secondary market, the programs are only as good as the day-to-day mechanisms that are in place for lenders to deliver their mortgages. With this in mind, we have recently announced a number of changes which I think significantly improve the access for borrowers and lenders to the capital markets through Freddie Mac.

Last month, we lifted the $5 million ceiling on the amount of home mortgages that lenders can sell in each weekly auction for our immediate delivery program. For noncompetitive bids, the limit was raised from $250,000 to $500,000.

Further, a major shift in the way Freddie Mac does business will take effect next month. We are moving from a weekly to a daily posting of the yields at which we will accept offers for mandatory delivery commitments. This change will give lenders much greater flexibility in using our programs and in managing their operations, including increased opportunities for hedging their risks.

While commitments were only available on a 60-day mandatory basis in the past, for most programs they will now be available for 30-, 60-, 90-, and 120-day mandatory delivery commitments. This greatly expands our ability to meet the delivery needs of a wide range of mortgage lenders.

We also have joined forces with the Home Mortgage Access Corporation (HOMAC), a subsidiary of the National Association of Home Builders, to increase

secondary market activity in another way-in a $500 million program. All of Freddie Mac's programs, and a new program to purchase 15 year fixed rate mortgages, will be available to builders through HOMAC.

Builders who are enrolled in the program will be able to obtain commitments to sell mortgages until the end of next month. Until the end of this year, any approved seller/servicer may convert the HOMAC builder commitment into a Freddie Mac purchase contract.

Initially, the builder reserves the funds for a one-half of one percent fee. HOMAC retains one-eighth of one percent, and pays three-eighths of one percent to Freddie Mac. However, the three-eighths fee paid to us is refunded directly to the builder when the reservation is converted to a Freddie Mac commitment.

To handle the increasing volume and types of activities in the secondary market, we are updating our processing capacity, making use of state of the art technology.

A major initiative for 1983 will be the use of SWAPs for new originations.

Finally, we will continue to work with thrifts as they search to find a more prudent strategy to invest in longer term mortgages. An essential element of this strategy is to improve the liquidity of their mortgage portfolios so they can sell these assets when necessary in response to changing market conditions. Several factors should be considered in this regard. First, these mortgages should be in security form. Second, the security should have high volume and be readily marketable, Third, the thrifts should be able to hedge these, for example, in established futures or forward cash markets. Our PCs fulfill all of these conditions. We want to give thrifts every opportunity to maintain their important position as the nation's supplier of home mortgage.

Standardization of instruments

While we are making many changes to accommodate the increased volume of secondary market activity, we do not think that this requires a great proliferation of mortgage instruments. In fact, as I have already mentioned, a move toward standardization is essential. Real estate brokers have frequently commented to us about the need to bring simplicity and standardization to the marketplace. It is our intention to do just that.

At Freddie Mac, we are beginning to focus on a few programs, which will be refined in response to borrower, lender, and investor needs. Whenever possible, we will replicate those mortgage instruments that have passed the market test. We hope to provide the homebuyer access to mortgage with a range of maturity structures—short, intermediate, and long term.

Just last week, I announced two new Freddie Mac programs in the short term range. In mid-April we will begin to purchase two Adjustable Rate Mortgages (ARMs) indexed to the rate on Treasury securities. These will be 30 year instruments, one in which the rate adjusts every three years tied to the three year Treasury rate, and one with five year adjustments tied to the five year Treasury rate. We have coordinated our efforts with Fannie Mae, so that after a lender originates a five year ARM, it can be delivered to either organization. We hope that these instruments will meet the needs of lenders to, in effect, shorten the maturity of their mortgage assets, while giving borrowers some degree of payment stability.

In the intermediate term range, we have already begun to take commitments through HOMAC to purchase 15 year fixed-rate mortgages, and we will begin to purchase them from all of our seller/servicers in mid-April.

For long term mortgages, our 30 year, fixed-rate programs will always be important. We are also giving close attention to mortgage instruments which address the affordability needs of borrowers—in particular first time home buyers. FHA experience has demonstrated the potential for widespread acceptance of graduated payment mortgages. We are therefore working on a Freddie Mac program for conventional GPMs.

VI. CONCLUSION

In conclusion, I would like to point out again that my general outlook concerning the housing recovery is optimistic. The demand is there. Now the key is to make the transition to a broader based delivery system for mortgage financing—one which provides borrowers with full access to the capital markets through an effective secondary market.

To assist in this transition, Freddie Mac is aggressively doing the following: developing new products to allow homebuyers to compete in all maturity strata of the capital markets; increasing flexibility in our purchasing system to assist lenders in coping with today's more volatile interest rates; using SWAPs to help portfolio lend-

ers develop more prudent strategies for investing in longer term mortgages; implementing special programs to help homebuilders; and placing emphasis on standardization to create the lowest mortgage rate for homebuyers.

EXHIBIT 1.—RECENT TRENDS IN HOUSING ACTIVITY

	Housing starts [1] (millions of units)	Mortgage contract rate (percent)
1980:		
1st quarter	1.252	13.73
2d quarter	1.055	14.43
3d quarter	1.385	12.65
4th quarter	1.500	14.26
1981:		
1st quarter	1.399	15.12
2d quarter	1.173	16.23
3d quarter	.962	17.43
4th quarter	.865	17.74
1982:		
1st quarter	.920	17.41
2d quarter	.952	16.76
3d quarter	1.118	16.17
4th quarter	1.251	14.02

[1] Seasonally adjusted annual rates.

Source: Housing starts—Department of Commerce Mortgage Contract Rate—FHLMC Primary Mortgage Market Survey.

EXHIBIT 2.—1–4 FAMILY MORTGAGE ORIGINATIONS (FHA/VA AND CONVENTIONAL)

Year	Savings and Loans	Savings banks	Commercial banks	Mortgage bankers	Other	Total
VOLUME OF TOTAL ORIGINATIONS (MILLIONS)						
1970	$14,814	$2,147	$7,797	$8,906	$1,923	$35,587
1971	26,603	3,540	12,598	12,487	2,560	57,788
1972	36,739	5,052	17,710	13,326	3,037	75,864
1973	38,441	5,912	18,782	12,657	3,334	79,126
1974	30,932	3,929	16,128	13,026	3,493	67,508
1975	41,242	4,333	14,450	13,992	3,896	77,913
1976	61,909	6,427	24,499	15,743	4,206	112,784
1977	86,304	8,660	36,675	25,651	4,685	161,975
1978	89,952	9,377	43,925	34,448	7,335	185,037
1979	82,825	8,962	41,415	45,260	8,733	187,195
1980	61,095	5,435	27,781	29,755	9,037	133,103
1981	41,980	4,022	21,689	23,958	6,666	98,315
1982[1]	35,020	3,799	20,174	26,550	5,304	90,847
RELATIVE SHARES OF TOTAL ORIGINATIONS [2] (PERCENT)						
1970	41.6	6.0	21.9	25.0	5.4	100
1971	46.0	6.1	21.8	21.6	4.4	100
1972	48.4	6.6	23.3	17.5	4.0	100
1973	48.5	7.4	23.7	15.9	4.2	100
1974	45.8	5.8	23.8	19.2	5.1	100
1975	52.9	5.5	18.5	17.9	5.0	100
1976	54.8	5.6	21.7	13.9	3.7	100
1977	53.2	5.3	22.6	15.8	2.8	100
1978	48.6	5.0	23.7	18.6	3.9	100
1979	44.2	4.7	22.1	24.1	4.6	100
1980	45.9	4.0	20.8	22.3	6.7	100
1981	42.7	4.1	22.1	24.4	6.8	100
1982[1]	38.5	4.2	22.2	29.2	5.8	100

[1] Origination data is available for the first 10 months of 1982.
[2] Rows may not add to 100 percent due to rounding. Regional Data Associates projections are used for the last 2 months.

Source: HUD, "Monthly Survey of Morgage Lending."

EXHIBIT 3.—GROSS 1–4 FAMILY LOAN SALES

[In millions of dollars]

Year	Savings and loans	Savings banks	Commercial banks	Mortgage bankers	Total
CONVENTIONAL MORTGAGES					
1970	365	28	170	485	1,048
1971	801	43	422	669	1,935
1972	1,886	21	996	1,357	4,260
1973	2,226	54	834	3,524	6,638
1974	2,688	58	929	3,759	7,434
1975	3,891	45	1,944	3,353	9,233
1976	6,611	121	2,622	3,687	13,041
1977	11,853	128	4,286	4,829	21,096
1978	13,609	266	4,574	7,808	26,257
1979	16,665	398	4,487	10,766	32,316
1980	13,314	638	5,582	7,705	27,239
1981	8,170	379	3,303	8,956	20,808
1982 [1]	10,500	1,614	1,388	9,690	23,192
FHA/VA AND CONVENTIONAL MORTGAGES					
1970	804	255	1,673	9,613	12,345
1971	1,763	175	1,971	12,394	16,193
1972	2,886	202	2,244	14,315	19,647
1973	2,759	161	2,010	14,980	19,910
1974	3,093	229	1,624	14,886	19,832
1975	4,726	234	2,931	14,451	22,342
1976	7,714	457	4,023	17,331	29,525
1977	12,955	221	5,839	27,372	46,387
1978	14,999	296	6,773	35,037	57,105
1979	18,108	521	6,574	44,412	69,615
1980	15,523	725	7,500	31,500	55,006
1981	10,097	446	4,023	26,715	41,281
1982 [1]	30,300	2,658	4,868	33,140	70,966

[1] Loan sales activity in 1982 is annualized based on activity through the first 6 months.

Source: HUD, "Quarterly Survey of Mortgage Lending." Activity in 1981 and 1982 has been reduced by FHLMC and FNMA SWAP activity.

EXHIBT 4.—FHA/VA AND CONVENTIONAL MORTGAGES PURCHASED BY POOLS AS A PERCENT OF 1–4 FAMILY ORIGINATIONS

[In percent]

Year	FHA/VA	Conventional Mortgages [1]
1970	2.8	6.5
1971	15.7	2.9
1972	15.4	3.8
1973	20.6	2.2
1974	34.7	3.6
1975	47.0	6.5
1976	76.8	3.1
1977	66.2	4.9
1978	47.8	5.6
1979	60.9	3.9
1980	72.7	6.6
1981	73.8	5.9
1982 [2]	84.3	5.4

[1] These numbers measure federally related mortgage pool activity. As indicated by loan sales activity (exhibit 3), overall secondary market activity is higher.

[2] Based on activity through the first 9 months of 1982.

Source: HUD, "Quarterly Survey of Mortgage Lending." Activity in 1981 and 1982 has been reduced by FHLMC and FNMA SWAP activity.

STATEMENT OF KENNETH J. THYGERSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL HOME LOAN MORTGAGE CORPORATION

Mr. THYGERSON. It is a pleasure for me to be here today to and address current conditions in the housing market, future prospects for a long-term housing recovery and the role of the secondary market and Freddie Mac in particular in assisting this recovery.

My comments today will focus on two issues. First, I want to provide Freddie Mac's views on whether housing market improvements in recent months are real or merely a short-term economic aberration.

Second, and just as importantly, I want to provide our insights into whether or not the Nation's home mortgage delivery system has the capacity to deliver the volume of mortgage credit our country will need in the years ahead.

In the time I have, I will summarize my written statement which has been submitted for the record.

ASSISTING THE HOUSING MARKET

For the first question, are we in the midst of a sustainable housing recovery, our response, like those preceding me, would definitely be in the affirmative. There is no need to review here the multitude of economic statistics which confirm that a housing rebound is taking place.

It is sufficient to say that the evidence is far-reaching and compelling. Many of those statistics you recited in your opening statement.

I am dubious whenever economists tend to agree, but Freddie Mac's economists would certainly agree that left alone the housing market in 1983 should improve throughout the year and produce a very respectable 1.3 or 1.5 million unit starts for the year.

That is the easy part of the forecast. The tough part is what happens next year. Whether this recovery is sustainable depends on whether the credit markets believe the budget deficits in 1984 and beyond can be significantly reduced and whether the Federal Reserve will be able to maintain discipline in monetary affairs.

Inflation must not be reignited again. Fiscal and monetary policies are the factors that determine the nature of the housing cycle and whether a housing recovery is sustainable or not.

Let me now address the issue of durability and capacity of our home mortgage delivery system. This is a significant question in light of the revolutionary—not evolutionary, but revolutionary changes that have affected the home mortgage delivery system in the last few years.

Congress must now be wondering if this new system can perform the enormous financing job that must be done in the decade ahead. Consider the following changes, all purportedly negative for housing.

Thrifts have been given vast new asset and liability powers. They have had to suffer through the worst financial environment since the thirties, an environment they were not structured to handle.

The industry's worth resources were severely diminished in the last 3 years. Over-the-counter savings have been unregulated, with the so-called differential advantage of thrifts largely eliminated.

Deposits have been shortened up. The money market accounts and super now's make it less prudent to invest in long-term illiquid and difficult-to-market mortgages.

Despite these revolutionary changes, a housing recovery is at hand. Why are we seeing a recovery taking place in light face of changes anticipated to be so harmful for mortgage finance prospects?

There are several good reasons. First, the variety of available originators for mortgage loans has broadened. Despite the decline in the thrifts' share of the market, others have aggressively entered the market, especially mortgage bankers, but also consumer finance companies, investment bankers, financial conglomerates, and others.

Also, the Garn-St Germain legislation will help the thrift industry to come back.

Second, the secondary market is working. It is working far better than anyone could reasonably have thought several years ago. Business is booming. It is booming at Freddie Mac, at Fannie Mae, at Ginnie Mae. Other entities are also entering the mortgage security market with substantial capital commitments.

Moreover, the capital market's appetite for mortgage-backed securities is broad and deep. I noticed today in the Wall Street Journal an item entitled "Ginnie Mae Has Special Charms for Investors." It is indicative of the broad market for mortgage-backed securities today.

Third, portfolio lenders with short-term liabilities are learning they can invest in mortgage-backed securities when it may be imprudent to invest in whole loans or participations. Mortgage-backed securities are marketable. They are liquid. They are easily hedged and they are priced competitively with other financial assets.

All of these factors highlight the importance of the secondary market and will help to insure that this is a durable housing recovery. Our mortgage delivery system is working well.

SUMMARY

Let me close by briefly summarizing what Freddie Mac is doing to insure that the home mortgage finance system of this country is up to the challenge of the eighties.

We have broadened our market by removing unnecessary fees and reducing paperwork. We have revamped our programs to insure that even the smallest seller servicers can make use of Freddie Mac. We have provided our resources to the Home Mortgage Access Corporation, HOMAC, to insure that builders of every size can be educated about and use the secondary market.

In response to demands from lenders, real estate brokers, investors, and consumer groups, we are moving to standardize the number and the type of mortgage products available.

In this regard, we are working with Fannie Mae to standardize documents for several of the more popular instruments. We continue to revise our guarantor program to be responsive to thrifts

and others who are finding that securities are more prudent and flexible investments than individual loans.

Just last week we announced several new mortgage programs based on existing successful products in order to insure that consumers be given access to a variety of successful mortgage loans.

We want to insure that home buyers have access to the whole maturity strata in the capital market with mortgages tied to short, intermediate, and long-term interest rates. We are pursuing this aggressive posture because we are convinced that the secondary market will be the key to the 1983 housing recovery and also because we think that the secondary market will be the answer to mortgage availability in the eighties and beyond.

Also, we recognize that there are enormous human and financial resources being committed to the markets we serve. It would be unfair to our stockholders to do anything less.

Thank you for giving me this opportunity to appear before you today. I commend this committee for reviewing housing conditions at this crucial stage of recovery. I look forward to your questions.

Thank you.

The CHAIRMAN. Thank you, Mr. Thygerson. May I compliment both you and Mr. Maxwell for doing an extremely fine job in the secondary market over the last couple of years during an extremely difficult period for everyone that has been involved in the local primary and secondary markets.

First, Mr. Thygerson, I am a little bit puzzled by your two comments. You repeated many of the things that I have heard over and over again during the hearing process starting in October 1981 about my bill, about all the harmful effects to mortgage lending, and then you also said it would be helpful.

So I am not quite sure where that balance is or whether it is really important. The only question I would ask you is, faced with those decisions over again and with Chairman Pratt's list of troubled institutions that is growing so large that I didn't want him to tell me about it anymore, that giving thrifts 10 percent asset powers and money market funds and with money market funds increasing at $2½ to $3 billion per week and most mortgage institutions, or a lot of them, not making loans—the biggest thrift institution in Utah hasn't made one for 2½ years—so theoretically and technically, under the law, all of these institutions were in the mortgage lending business, but they were not actually making loans.

NEW LEGISLATION LIFE-SAVING TOOL

I had no doubts then, and have no doubts now that as a result of the legislation, granting new powers and new opportunities to compete with money market funds, there will be a reduction in the percentage of their assets going into mortgage loans over the past years, whatever that is. If it drops to half, isn't that a lot more than nothing?

Mr. THYGERSON. First of all, let me clarify any ambiguity in my statement. What your legislation and Congressman St Germain's legislation did was to throw out a lifesaving tool to this industry

which, as Chairman Pratt stated, would otherwise probably not exist today.

I was managing one of those institutions a year ago, and I know the problems that existed in that marketplace. I remember how hamstrung we were in our ability to adapt to a changing market economy.

I was one of the strongest supporters of the legislation that you sponsored, which was fortunately passed. If that legislation had not been passed, I can assure you that our institution and others like us would have had no probability of success as a financial institution.

Moreover, our ability to be a participant in the mortgage market in the future would have been seriously jeopardized.

What I believe we are seeing today is a chance for those institutions to come back. I believe that they are coming back in a number of ways, using a variety of tools that you gave them. I think we are also going to find that those institutions will continue to make a major contribution in the mortgage market.

They will not do this so much as a portfolio lender, putting mortgage loans into their portfolios and sitting on them for 20 or 25 years. Rather, they will continue to originate mortgages, in small and big communities and make available their expertise. However, I believe that an increasingly large number of these lenders will deliver this product into the secondary market.

We will pool these mortgage loans and sell them in the form of securities. These securities will be made available to institutional investors that have a better match of assets and liabilities.

So let there be no doubt that what you did was necessary. Your legislation was highly significant and, as Chairman Pratt said, clearly the most important financial legislation since the 1930's.

The CHAIRMAN. I frankly wished, as I said many, many times, that it had not been necessary. The marketplace has been changing so rapidly, I am one of those who felt it was necessary to respond. As I have said over and over again, I wish we could come back to the good old days, whatever the good old days were.

But let me ask you, Chairman Pratt, what is your response to those—and there are still many who obviously disagree with the legislation and wish return to those so-called good old days of tight regulation, including regulation Q—financial institutions that have existed for so many years, especially the traditional housing financers, the savings and loan industry?

Mr. PRATT. Well, I share your feelings that, whatever we might like to do, it is impossible to return to "the good old days." It simply can't be done. Technology has passed that system by.

The ability to move huge amounts of funds nationwide and worldwide instantaneously, the development of the computer and telecommunications, has simply made obsolete the old system of having a nice little geographic monopoly where no one else offered financial services in your neighborhood, where there were no unregulated money market mutual funds, and no industrial companies that could perform financial services. Those times can never return, and they weren't the good old days in the sense of creating efficient financial markets.

Today, I believe, the saver is getting the highest return on his money relative to the cost of loans, that has ever occurred, and financial markets are going to be tough for those who are in them, for banks and savings and loans and others.

That simply means that they are going to have to do their job for a relatively minor spread, and that is of benefit to the American people, and that is who ought to receive the benefit.

The CHAIRMAN. Later on in the next panel, Mr. Shane of the U.S. League of Savings Institutions says, "If Government deficits are not quickly brought down to reasonable levels, there is likely to be an acute shortage of funds available for housing."

I share those views and so stated in my opening statement today. There is a large body of thinking that agrees with both of us.

FINANCING "A LARGE DEFICIT"

But you indicate in your testimony, and I quote, "A large deficit could be financed without causing a sharp increase in interest rates."

What I would like you to do is elaborate on what your definition of "a large deficit" and what loophole we can expect without an increase in interest rates.

Mr. PRATT. My testimony shouldn't be misunderstood to indicate that I in any way am pleased with large deficits or would support the continuation of it.

The CHAIRMAN. I know that. That is why I asked the question.

Mr. PRATT. I am a strong supporter of the market system performing the actions which are necessary for the people of this country. Given the relatively low level of the present economy, we don't see immense demands for corporate credit and other demands competing with the government. If the large deficit can ever be financed, I suppose it is in this type of a scenario.

In my opinion, clearly it would be to great advantage to cut Government spending, reduce the size of that public sector, and increase the size of the investment savings sector on the private side. And I believe all of our actions have been geared toward that.

In the absence of overstimulation of some sort, I guess we don't see an immediate return to high inflation and high interest rates, but clearly that deficit has to be dealt with, probably as the No. 1 structural problem in this economy.

The CHAIRMAN. Essentially what you're saying, you feel, at least for a relatively short period of time, a year or so, if we've got enough slack in the economy, that you're not going to see an immediate return to high interest rates. That's one of my fears, as I said a moment ago in my statement, we need a very careful balance.

I so strongly feel that interest rates—for a lot of reasons, but the No. 1 key is lower interest rates. I feel if we don't send the proper signals to Congress, rates may start going back up.

Do you feel at least some slack in the short term——

Mr. PRATT. I think we have a few months, especially if the Congress and the administration indicate their intention to deal with the problem. But I can't overemphasize the vulnerability which I think thrift institutions, and probably one of the major secondary market operations, Fannie Mae, have to a rapid return to very

high interest rates. It would certainly cripple this very good recovery we're seeing from the private sector, the housing sector, which has let us into recovery so many times before.

The CHAIRMAN. Gentlemen, my time is not up, but I'm going to stop early, which is unusual for a Senator, I realize that, so we can accommodate the other Senators and also the additional eight witnesses.

Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman. I think this has been a very important set of presentations, and I compliment the witneses for your preparation and the content of what you had to say here.

It appears to me that there is a consensus that interest rates are a critical factor for recovery of the economy. We are now seeing the possibility of a recovery if it doesn't get away from us. The great apprehension is it may get away from us.

It seems to me what has happened here is that we managed to get the interest rates down essentially by shutting down a large part of the economy in a very serious recession; we're beginning to come out of it, but we're still stuck with a very high deficit, as a matter of fact, deficits increasing rather than decreasing.

But at some point you get a boomerang effect. You can have lower interest rates because the economy is profoundly weak, even though you've got the anomaly of rising deficits. But you can't stay in that condition indefinitely. As the economy starts to come back and we start to get the higher level of activity which we all want to see and those deficits stay as large as they are projected, then I think we're caught with interest rates being driven back up. I don't see any way out of that trap, unless we somehow make some changes in it.

So I'm very much concerned that we're in a very fragile period, which is what I hear you saying as well, and I think an enormous job has been done in the midst of these difficulties to try to stabilize things as much as possible and to get through this period.

I'm impressed by the performance that has been both achieved and highlighted here. The thing that concerns me now, though, is where do we go from here, and can we get out of this situation with rising strength and a stronger housing market on a sustaining basis over a period of time.

FUTURE HOUSING DEMANDS

I'd like to ask two questions, I'd like each of you to comment on it. What is your best estimate of the housing demand over the next 5 years. This is the same question I was raising with Secretary Pierce. Would you also include in your estimate of the need for new housing the number of people who have been jammed and unable to get into the housing market?

Second, I would like your sense for how the new money market accounts at savings institutions and the competition that's going on and the higher rates that are being offered, pulling in money to a certain extent, moving money around through different accounts, how do you perceive that new development impacting the availability of mortgage money somewhere in this 12- to 13-percent range,

which seems to be the tip point. If we get down to that level or below, we get a surge in housing; if we get above that level, the housing really seems to slack off.

I would like each of you to offer whatever thoughts you have on both of those items. Mr. Maxwell, why don't you start?

Mr. MAXWELL. Senator, the question of housing demand is an elusive one because people can double up—your grandmother can live on the third floor. We conducted a very extensive consumer survey recently with Louis Harris & Associates. One of the significant findings of that survey is that 72 percent of people who are now renting thought that their next abode would be a house that they owned, that's what they wanted.

It seems to me that because of demographic factors, the baby boom coming into the traditional homebuying age, and if you will, the social tradition of the country, that there is a substantial demand for housing. I wish that I could quantify the exact numbers, but it seems to me that enormous amounts of capital will be needed for housing during the 1980's to meet the demand.

I think that Secretary Pierce said something that was very significant when the FHA rate goes down, all those people come in to get loans. A lot of that is refinancing right now, but the fact remains that we consider the housing demand to be large, and that has always, at least in the last several years, been the case. People have written for years about the baby boom coming of age at this time and the demands would be heavy——

The CHAIRMAN. If I can interrupt you for a moment. When you speak of the baby boom, I would like to announce here publicly that my little daughter was 8 months old yesterday. That will be my last contribution to the baby boom.

I can't speak for Senator Thurmond, but I can announce that I will not be having any more. [Laughter.]

Mr. MAXWELL. You're just the cutting edge of the new baby boom. So we think the demand is heavy and we think the need for capital for the housing market will be great. Perhaps a trillion dollars during the rest of this decade.

Senator RIEGLE. A trillion in the rest of the decade?

MMF'S RATE DROP

Mr. MAXWELL. As far as the new money market accounts are concerned, in our view the rates that have been offered to attract people to take those accounts will come down, and this is an extraordinary source of funds for thrift institutions and banks.

The rates ultimately will probably be close to the rates on comparable Treasury securities in order to keep them above the money market funds. We believe that the thrift institutions can compete on that basis and they will.

So we look for a stable supply of funds, and I agree with what Chairman Pratt said, that this legislation really did go a long way to saving the thrift industry.

I think a lot of that money will be invested in mortgages, and this is where the secondary market becomes so important. Fannie Mae has purchased 120 different kinds of adjustable rate mortgages over the last 18 months. The reason we did that is that we

were a market; we were responding to local conditions all over the country, helping builders to move the inventory and lenders to move their product.

We believe there will continue to be some variation on types of adjustable rate mortgages throughout the country, and we hope that there will be more standardization developing, but we see our role as being able to provide a market to liquefy these mortgages for the thrifts that are willing to make them.

Also, thrifts will want to make the kind of mortgages they can sell to Fannie Mae, Freddie Mac, or keep in their portfolio, depending on what their situation is at any particular time with respect to liquidity.

Senator RIEGLE. If long-term Government securities are the rate of about 10 percent, and money market accounts and savings institutions are in that same ballpark, is that rate sufficiently low to let them lend at the 12–13 percent rate? What percent of that money will be drawn into mortgages versus other kinds of activities? In other words, do you think if we can keep it at that level we can take command of this thing on a sustained upturn?

Mr. MAXWELL. Yes, I do. And I think that there will be some 30 year fixed-rate mortages to be made which will be sold in the secondary market and put into the securities for investors who need it or want that kind of investment.

But I think it would be a two-tier market. I think the 30-year, fixed rate mortgage will carry a higher interest rate than the adjustable-rate mortgages because of the additional risk of the 30-year loans.

Senator RIEGLE. I know time is running, maybe I could just get brief responses?

Mr. PRATT. I think we've gone through an interesting housing cycle. I would view that in 1980 we probably had substantial overinvestment in housing. The rapid escalation in housing prices that has occurred, along with the very high interest rates, meant that the implied carrying costs for the house are very large.

In my own case I purchased a modest house for $35,000; it was probably worth $150,000. Had I been able to move it on the market at that time or desired to do so and invest it at 18 percent, I'm not sure I might have opted for less house and the income from that.

So I think we had as a result of economic circumstances somewhat of an overinvestment for a period of time. Second, the demand of course is an economic factor. Demographic need or social need is a different entity, and people will differ on that. Demand is whatever it is.

I would be surprised if we see any sort of effective economic demand for the 1.8 million per year for the next 5 years. I think, given the increasing costs in society and other factors and the lower returns, that it probably won't be possible for a young family to get as much as a 100 percent return on their investment in housing which occurred sometimes during the seventies.

There were periods where that return was met or exceeded by a family buying a house for 5 or 10 percent down and 1 year later seeing the house, having increased in value by more than 5 or 10 percent, giving them fantastic returns on their money and making this the great go-go investment of part of the seventies.

If we can believe that inflation is going to be controlled and moderated, I wouldn't expect to see those kinds of returns from housing; therefore, I think people will stretch a little less than they did in the past to get into owner-occupied housing.

Second, if in fact those returns aren't available, I think people will scale down their demands for the size of housing and the capital-intensiveness. What is an adequate house? Is it 800 square feet, or is it 1,300 square feet?

We see tremendous differences around the world. I think in a stable, noninflationary economy, we'll probably see some scaling down of the size of house demanded. I believe we have already seen that.

To the extent the financial markets work more efficiently, perhaps there will be less implied financial subsidies to homeowners. In the past, to the extent that we limited savings and loans to only single-family mortgages and at the same time gave them a preferred position over the commercial banks due to regulation Q and didn't have money market mutual funds and others competing in the market, we may have been funneling some subsidy into the borrower. I believe that subsidy has disappeared for at least the immediate future, unless Congress were to act in some explicit fashion.

So I would see housing demand perhaps in 1.5 to 1.6 million units for the next few years, and those housing units being somewhat smaller than when we arrived at the peak of the cycle.

NEW FUNDS INTO THRIFT INSTITUTIONS

The money market demand account, I think, has several salutary effects: One by bringing new funds into institutions, it simply gives them some room to maneuver and operate and to feed back into the business rather than sitting back and atrophying.

I think in that sense it's very positive; I think it channels funds from what was a relatively sterile direction through the money market/mutual funds, sort of an unnecessary intermediary, into a direct intermediary that serves small business, large business, and homeowners. So it channels the funds to the direct lenders and risk-takers. I think it's positive in that regard.

Second, I believe a good deal of it will flow into mortgages and mortgage-related activities, some of it directly into the variable-rate mortgage where it will be quite appropriate; some of it into the supporting development, maybe short term construction loans, development loans, the other infrastructure items associated with housing development; and finally, properly or improperly, some of it will flow into long term fixed-rate mortgages. That is of course a more risky venture for institutions, but I think that will occur.

I also believe that the deregulation of the mortgage instrument is very important; I think we need to make sure that the climate is a good one for everything from very short term variable-rate mortgages to the continuation of the long term, fixed-rate mortgage.

I think we need to defend the long-term fixed-rate mortgage and the right to offer that in the market and it is a very important social service to the American public. But I see the circumstance as being a good housing demand in the next few years, lower than the

demographers have probably told us, the money market demand account being positive.

Mr. THYGERSON. I guess I'm the clean-up hitter with two able witnesses before me, so my job is relatively simple. I would agree with Mr. Maxwell that the answer to your question about housing demands is the most elusive question in the housing area.

What we're finding is that the simple models of housing demand we used a dozen years ago have simply broken down. We found that the interest rates, household formation changes, the willingness and desirability of doubling-up, even divorce rates, affect what's available in the housing market. We have conversions from residential to commercial, from commercial to residential. They change as well.

I think the true test of whether we have a significant shortage of housing is what's happening to the price of housing. The price of housing in the last few years has, if anything, moderated. This obviously has resulted from the high interest rates, recession and so forth.

But in terms of real evidence that there will be a significant shortage for housing in the years ahead, the evidence is not overwhelming.

So I think our concern should be focused primarily on upgrading what is inadequate in terms of current housing stock. I think that's where the stress should appropriately be placed. The money market account has clearly been beneficial. It has helped to liquify these institutions by allowing them to compete for other account relationships.

The fact is, you get a money market certificate or an account with one of these institutions, and it helps them to sell you an IRA, or helps them to sell you a long-term certificate.

That's really the kind of benefit I see resulting from these accounts.

As Chairman Pratt mentioned, what we're finding is that these institutions with this new money are able to participate in the mortgage market, but they participate in a different way. They do not buy a 30-year mortgage, put it in their portfolio and sit on it. They go out and buy a mortgage-backed security and hedge it in the futures market, or they sell it into the cash-forward market, or they sell an option against it.

They use a whole variety of esoteric financing schemes to, in effect, convert an illiquid, long-term investment into something they can prudently invest in for short-term funds. So it's clearly helpful.

Senator RIEGLE. Thank you.

The CHAIRMAN. Senator Heinz?

Senator HEINZ. Mr. Chairman, two questions. First of all, Mr. Maxwell, in your testimony, you indicated reasonable optimism about the level of mortgage rates this year, some pessimism about their ability to stay down next year. You also, however, indicated that the 30-year Treasury bills were selling at somewhat above the level you would expect relative to a mortgage interest rate 30 years: 13 percent.

And I was wondering whether that in fact doesn't mean somewhat more pessimistic news for this year, not just next year. Why,

if it's—if you expect bad news next year on a 30-year security which the mortgage is, would the expectations that you have higher rates next year not influence the rates this year?

Mr. MAXWELL. Well, Senator, I think some pessimism has crept into the markets already. We noticed in the last month or so that rates have backed up, which I think was a surprise to a lot of people.

I don't think I am foolishly optimistic, but I choose to be optimistic because I think that as a matter of public policy, the idea of higher interest rates at this stage in the economic recovery is unthinkable. I believe the Federal Reserve Board——

Senator HEINZ. You mean you don't want to think about it? Is that what you mean by "unthinkable" or that——

Mr. MAXWELL. No, we have to think about it for $73 billion invested.

Senator HEINZ. I don't want to think about it, but I am afraid it might happen.

Mr. MAXWELL. It might because there is tremendous jitteriness in the market that every time a recovery shows signs of beginning, the market gets frightened and interest rates back up a little bit.

I think the only cure for that myself—and I certainly don't presume to put myself in Mr. Volcker's shoes because he is far more qualified than I—but I do believe that the Federal Reserve Board should continue to insure that interest rates do not turn around and go back up as a matter of policy.

DEALING WITH THE DEFICIT

Senator HEINZ. Do you think the Fed could do that if the Congress was unable to reduce the national debt over the next several years much below 100 percent of net savings?

Mr. MAXWELL. I think the question of the national debt is really a question of what is going to happen in the years——

Senator HEINZ. Let me correct what I mean, the annual deficit, not the national debt.

Mr. MAXWELL. I think that the question of dealing with the deficit is really a question of the structural deficit. I believe that the deficit caused by the recession, if in fact the recovery begins to develop, will be reduced by the very fact of the recovery. I think that certainly the markets will be watching, and I suppose the Federal Reserve Board will be watching to see if Congress can come to grips with the deficit problem..

I think the Social Security compromise that you were part of was a very positive step in sending a signal to the markets. That the Congress is serious about dealing with the structural deficit in future years.

Senator HEINZ. I like what you say about the social security compromise, and the latter part of what you say remains very much to be seen.

Just as I might add, I commend you in your optimism, I hope and trust the chairman's optimism on his family planning strategy is well-placed. The definition of "enough" as "enough" is recorded, well-noted, and congratulations. [Laughter.]

Both on your recent redefinition as well as your future plans.

One last question——

Mr. MAXWELL. Senator, can I just say that I am not an economist, I am a lawyer, and I never forget Sam Goldwyn's admonition, "Never make predictions, especially about the future." [Laughter.]

Senator HEINZ. We trust that all members of the committee and Mr. Chairman will take careful note of that in all things.

I have one question for Dick Pratt regarding delinquencies and foreclosures. You in your testimony at page 19 have a chart showing that delinquencies are at an all-time high, at least in the decade, that they have reached over 2.2 percent of total mortgage loans and contracts.

Second, would it be accurate to say that, although foreclosures at this point don't seem to reflect the delinquencies, is this not an historic rate of delinquencies even for the sixties?

Mr. PRATT. Yes. We didn't collect delinquency statistics in the sixties. All we had were foreclosures, so this would be a historically high rate for delinquencies.

I think also that the relationship between delinquencies and foreclosures, does indicate that the financial institutions are not especially eager to roll into foreclosure and have a lot of self-interest in trying to work with borrowers.

Senator HEINZ. I am concerned that we are going to see more, not less, in the way of foreclosures, and Mr. Richard Bording in the Housing Economics Division of the Library of Congress, Congressional Research Service, in a table to January 1983—and I am indebted to Senator Riegle for sharing a copy with me—provides some interesting statistics on the way foreclosures are trending, in a way that is rather difficult to develop from any of the previous information.

What it basically shows is that foreclosures have had a pattern to them but were around 85- to 90,000 loans in foreclosure, and we held that level about through the third quarter of 1980. Then in the fourth quarter of 1980, the first quarter of 1981, there was a jump of roughly 30,000 units, to a level of about 110,000 to 120,000 loans in foreclosure at the end of each quarter.

And that—for about a four-quarter period, that level held, basically throughout all of 1981. So you had a step function, and things appeared to level off.

But then, at the end of 1981 there was another jump, again by about 30,000 loans in foreclosure, to roughly a level of 150, which was reached in the first quarter of 1982. And in contrast to having held at that level for four quarters, that level was only maintained for two quarters, the first and second quarters of 1982, before it jumped another, in this case, 20,000 units to a level of 170,000 units in the third quarter.

Now what this suggests to me very clearly is that the length of time we are holding at a particular level is getting shorter and shorter before we jump to the next higher level and that, indeed, the rate of increase in foreclosures is accelerating geometrically. This is not a straight line; this is a progression of some geometric nature.

What information do you have to suggest that this extrapolation that I have set forth to you is, indeed, wrong.

Mr. PRATT. Well, I have no reason to believe that your figures are incorrect. I don't know that it is something that shouldn't be expected for two reasons.

One, to the extent the public believes that we may have some chance of controlling inflation, I believe there is some reason to believe this. I think that fact and the fact that inflation itself drops should increase the rate of foreclosures rather substantially.

During the sixties and seventies, as I mentioned earlier, housing was one of the better performing financial investments, with prices going up rapidly, and one would expect foreclosures to certainly be at an abnormally depressed rate during the period of that time, because the increase in the housing price would mean that even if an individual was unable to afford his house, rather than have it go into foreclosure, he would sell it.

So you don't really know in a noninflationary period what the actual duress is as compared with a period of various substantial inflation.

Two, as we got to the very hot housing markets of the late seventies, one must try and differentiate somewhat perhaps between the speculative demand for housing and some sort of demand that was a true need for shelter on the part of families.

To the extent that an individual did take essentially a speculative venture, put a low payment down, perhaps at a high mortgage rate, and then sold, the price of the house not escalating, it may have been to his financial advantage to let it go to foreclosure rather than taking some other measure.

Now this is not to mitigate the very real problems that occur because of the depressed economy, but I think we should lay the blame where it actually is, the unemployment and the depressed economy, not in the housing sector itself.

And I believe that Congress can best deal with that by examining those areas of unemployment, those areas of difficulty, and try to deal with them directly.

Senator HEINZ. My time is about up. My point is only this. I don't disagree that we should—that the fairest way to address the kinds of economic hardships people have is through, for example, an extension of unemployment compensation. But whether or not we get it is another question. And we have to consider possible alternatives absent that.

IS THE WORST OVER?

We may not get the policy you or I want. So my question is only this. We have had some testimony today that says the worst is over in terms of foreclosure. My question is, is it?

Mr. PRATT. I think there will be two factors. One, if we get the recovery that is occurring, I think that that will mitigate the rate of foreclosures.

Two, to the extent that we have really controlled inflation, I think that foreclosures will be higher than we would have expected.

The sixties again may be a pretty good example there, where they were running close to 1 percent in what most of us think are

pretty much the good old days. That was a period of virtually no inflation.

Senator HEINZ. If I could just try and get you to agree or disagree with words I am going to attempt to put into your mouth, would you agree that foreclosures are likely to get worse for some period of time before they get better?

Mr. PRATT. I wouldn't be surprised, and I would not be highly surprised to see us go to a level perhaps of about the rate of the sixties, which was twice as high as the present level.

Senator HEINZ. So we could reach that rate?

Mr. PRATT. Yes. I don't have an explicit model which would indicate that, but my own reasoning and the factors I discussed with you today would lead me to believe that that would be a possibility, again as a function of the recovery and interest rates and other items.

Senator HEINZ. Mr. Pratt, thank you.

Mr. Chairman, I want to thank the members of the committee for allowing me to run over a couple of minutes. I just wanted to finish that line of questions.

The Chairman. Senator Lautenberg.

Senator LAUTENBERG. Just a few questions, if I may, Mr. Chairman, since I am still in the process of familiarization. I need some information.

The Chairman. So are all of us.

Senator LAUTENBERG. That makes me feel better. I was concerned about one remark that you made, Mr. Thygerson. I didn't know whether you were connecting the divorce rate with the conversion of residential property into commercial property.

Mr. THYGERSON. I hope not.

Senator LAUTENBERG. That doesn't require a response. [Laughter.]

COMPETITION FOR FUNDS

The thing that concerns me, or at least that I think offers some challenge in terms of the way capital is available, has to do with the difference in competition for funds. Certainly when you look at the investments in savings institutions that we might make in terms of mortgage commitments, the illiquidity that results, the costs for getting money in, as contrasted with the opportunity to get money back are very significant; and I for one do not believe that we have yet seen the results of the competition from money market funds with savings institutions, and so forth.

A lot of these services are given away typically in financial institutions that are not recorded transactions, and which are very costly to administer and provide. And when, there has been enough of this, we are going to see that there is not an abundance of capital available.

Also, I would be curious to know, if anybody has any indication of the percentage of fixed rate, long-term mortgages being made available today versus the VRM. And I believe you suggested there were 120 types, of VRM's.

Mr. MAXWELL. What I said, Senator, was that Fannie Mae purchased 120 types. We actually had a basic program of eight differ-

ent kinds. But builders, particularly, would come to us from all over the country, and they would say, "I have a particular variation on one of your types that will move my product. Will you buy it? If I can have your commitment, I can go to a local lender and get money."

And in this kind of market we responded with all kinds of buydowns.

Senator LAUTENBERG. Thank you. So I don't know whether anyone has a feel for the relationship of fixed long-term mortgages versus the VRM, whatever type they maybe.

Is there any indication?

Mr. THYGERSON. I would say the majority of mortgages originated are the fixed rate variety.

Mr. PRATT. I would support that. I would think they would clearly be in the majority at this time.

David may speak to this more knowledgeably, but certainly the FHA has been an immense growth sector. Also a very strong growth sector has been the State and local mortgage programs through housing agencies of one sort or another, and these tend to be fixed rate long term. It would be my indication, clearly, the fixed rate long term is in the majority.

Mr. MAXWELL. Certainly, in our $15 billion in purchases last year there were far more fixed rate 30-year mortgages than there were adjustables.

Senator LAUTENBERG. Than were adjustable?

Mr. MAXWELL. Than were adjustable.

Senator LAUTENBERG. More fixed than adjustable?

Mr. MAXWELL. Yes, sir, but we can probably give you some better fix on this, Senator.

Senator LAUTENBERG. That would be very interesting, because what I suspect is, as these things get sold, a lot of savings institutions are doing mortgage services.

Am I correct there?

Mr. MAXWELL. Yes.

Senator LAUTENBERG. And the last guy who winds up with this hot potato in his hand, might take a licking. I suppose, frankly, that there is a marketplace out there for long-term fixed mortgages.

ATTRACTIVE MORTGAGE RATES

Mr. PRATT. Senator, one comment on that. The long-term fixed rate mortgage has some very attractive aspects associated with it.

One, it tends to provide great safety. It has historically. Two, it does provide a yield over Treasury Government's. And, three, it tends to be much shorter term.

When we have a normal mobile, fluid economy, as this country has been characterized with, 6, 7, 8 years is the actual maturity of that 30-year mortgage, and yet it is a very good yield related to a 30-year Treasury and a 20-year Treasury.

I suspect its attractiveness is going to remain both to the homebuyer, borrower, and to investors.

Senator LAUTENBERG. I respect your point of view, Mr. Pratt, and I think you made a very important statement before about the

upward mobility or the upward movement in price, on property, housing in particular, that it was easy to deal with a 6-year term.

When there isn't that appreciation, I don't think you will see the same flexibility in the marketplace as we have seen in the past, and I don't know that we are going to be able to see this 6-, 7-year kind of flexibility that we typically see in the marketplace.

In response to the number of foreclosures, are we likely to see a higher foreclosure rate as a result of the variable term mortgage's balloon at the end of the term? An individual enters it optimistically—taking a 30-year term, 25-year term, 5-year mortgage, 5-year payout, and takes the balloon at the end of the period only to find out, "Hey, property not only hasn't gone up, it has gone down." The situation changes.

I think that might have a deleterious effect in the future on the foreclosure rate.

Do we know in terms of housing demand how that is affected by the size of house?

Someone mentioned before that we were seeing smaller units. Someone mentioned the figure 800.

Mr. PRATT. I was not trying to be precise. I don't know if you have homebuilders testifying, but I think they will testify to the effect that there has been a downsizing and that we are going through somewhat of the same situation as the air prices got in transportation.

The CHAIRMAN. We have a homebuilder about 7 o'clock tonight. [Laughter.]

Senator LAUTENBERG. Is that a hint, Mr. Chairman?

OK, let me ask this, and maybe this will be answered in the homebuilder's testimony, but in terms of the number of square footage—could we obtain some information along these lines? Also what is the demand for single-family housing vis-a-vis that of multiple family housing rental units?

There is a shortage, I believe, throughout the country in terms of rental property. Does that give some incentive, some extra demand for single family houses that might not be there based on the economic viability of the purchaser or that would create a false impression about our housing needs?

Mr. MAXWELL. As I testified, Senator, our survey that Louis Harris conducted, aside from the shortage of rental housing, showed that 72 percent of the people who rent plan to move, want to move into a home of their own. I think there is demand for homeownership by renters.

MORTGAGE INSURANCE

Senator LAUTENBERG. One more question, and that is, are the provisions for mortgage insurance typically the same for second homeowners or resort homeowners, as they are for the first home purchase? Are the protections the same? Can one get an FHA loan?

Mr. PRATT. It is my understanding that FHA insurance is not available for the second home, except for investment properties under certain circumstances.

Mr. MAXWELL. Mortgage insurance is the business I used to be in. It would require in most cases a lower loan-to-value ratio on a second home than on the first home, when they provide the insurance. But, they do sell that insurance.

Senator LAUTENBERG. Since everybody has agreed that more capital is needed to continue the recent housing starts, is there any indication that some clamping down on demand for second mortgages that, for example interest deductibility; would have any effect in making capital available for those who would like to purchase a home for the first time?

Mr. PRATT. Senator, let me just speak to that, and this is only personal opinion, because we don't have a study on it, but I believe that the second home situation is sufficiently insignificant, relative to total capital demands in the market that it really wouldn't have any effect at the margin. And when one looks at the present sort of economic circumstances with certainly tremendous excess capacity in timber, lumber, building materials, and nearly every other sector, and major unemployment problems in the areas that provide these, one should not be totally unaware of the stimulating effect of those properties which is as great as the construction of single-family owner-occupied houses.

So policies which might be designed to discourage those in some way should perhaps at least be sensitive to the needs of the economy, and not overlook the benefits of the kind of cyclical support that they might give from time to time.

Senator LAUTENBERG. Thank you very much.

The CHAIRMAN. Thank you. Senator Hecht?

Senator HECHT. No, nothing.

The CHAIRMAN. I would just comment on our own State.

As Chairman Pratt has just said, during an extremely difficult time for our homebuilders and construction people, about the only place that we had any construction at one time was in Park City, where they were building a lot of luxury condominiums, and carpenters, plumbers, bricklayers, everybody was working. They didn't care whether it was somebody's second home. They were just tickled to death to be building something.

Gentlemen, I thank all three of you for your testimony today. We appreciate your time very much.

I would ask, as rapidly as possible, if we could have the second panel come before the committee. Mr. James M. Wooten, president of the Mortgage Bankers Association, Mr. Leon T. Kendall, president, Mortgage Insurance Co.'s of America, Mr. Herbert Gray, president, Mutual Savings Bank Association, Mr. Leonard Shane, chairman of U.S. League of Savings Institutions.

STATEMENTS OF JAMES M. WOOTEN, PRESIDENT, MORTGAGE BANKERS ASSOCIATION, LEON T. KENDALL, PRESIDENT, MORTGAGE INSURANCE COMPANIES OF AMERICA, HERBERT GRAY, PRESIDENT, MUTUAL SAVINGS BANK ASSOCIATION, AND LEONARD SHANE, CHAIRMAN, U.S. LEAGUE OF SAVINGS INSTITUTIONS.

The CHAIRMAN. Gentlemen, we appreciate your patience very much. After sitting for nearly 3 hours, if you want to stand and give your testimony you are welcome to do so. [Laughter.]

Mr. Wooten, would you like to begin, please.

[Complete statement follows.]

STATEMENT OF JAMES M. WOOTEN, PRESIDENT, THE LOMAS & NETTLETON CO., DALLAS, TEX., ON BEHALF OF THE MORTGAGE BANKERS ASSOCIATION OF AMERICA [1]

Mr. Chairman and Members of the Committee, my name is James M. Wooten. I am President of the Lomas & Nettleton Company, a mortgage banking firm headquartered in Dallas, Texas. I am also the President of the Mortgage Bankers Association of America, which is the trade association of the Nation's mortgage banking industry. Accompanying me are Burton C. Wood, MBA's Legislative Counsel and Sharon M. Canavan, MBA's Associate Legislative Counsel.

We appreciate the opportunity to appear before you today to express our views on the current state of the mortgage finance and housing industries. Our comments will principally focus on the current and future impact of the economic situation on the mortgage finance industry, the prospect of and necessity for a mortgage foreclosure relief, and measure the ability of the secondary market to provide adequate supplies of mortgage credit.

ECONOMIC OUTLOOK

The Nation's economy, led by a resurgent housing sector, is finally emerging from the longest recession since the Great Depression. Increased spending on new home construction, combined with the demand for mortgage financing that is the result of major declines in mortgage interest rates over the past few months, will be a strong engine of growth for the economy in 1983. MBA forecasts that housing starts in 1983 will total at least 1.4 million units, up considerably from the 1.06 million units started in 1982. Inventories of new homes for sale are near their lowest levels in ten years, meaning that even a gradual upturn in home sales are near their lowest levels in ten years, meaning that even a gradual upturn in home sales will result in renewed construction. Sales of existing homes are also picking up as sellers offer units that had been held off the market. Loan applications, especially for Federal Housing Administration (FHA) and Veterans Administration (VA) programs, are at all-time highs.

Indicators other than housing are also showing signs of recovery. Business inventories, cut sharply in the fourth quarter of 1982 by nearly $18 billion in constant dollars, will decline only slightly in this first quarter. While some businesses will remain cautious until consumer confidence improves, this bottoming out of the inventory cycle is a major sign that the economy is on the mend. Auto sales are rebounding in response to declining financing rates. Larger than normal tax refunds, a result of the Treasury Department's delay in implementing last year's tax cut fully in withholding from upper-bracket taxpayers, will also play a role in boosting consumer spending. Consumer debt-to-income ratios are at their lowest point since 1974-75, meaning that people who are working have the ability to take on the debt necessary to finance more expensive items, such as homes and cars. As consumer outlays rise, production will resume.

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[1] The Mortgage Bankers Association of America is a natiowide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage orginators, mortgage investors, and a variety of industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in orginating, financing, selling, and servicing real estate investment portfolios. Members include: Mortgage banking companies, mortgage insurance companies, life insurance companies, commercial banks, mutual savings banks, savings and loan associations, mortgage brokers, title companies, state housing agencies, investment bankers, and real estate investment trusts. MBA headquarters is located at 1125 15th Street, N.W., Washington, D.C. 20005; telephone: (202) 861-6500.

Because of the Federal Reserve's resolve in cooling inflationary pressures, the economy will experience only moderate inflation, at a 5 to 6 annual percentage rate, during 1983. While this will help to keep pressure off of interest rates, the Federal deficit problem has caused investors to fear a resurgence of inflation and to demand a premium for this risk, keeping interest rates at higher than normal levels today, and in prospect for several years to come. The economic recovery that is approaching however, is not likely to be of the normal strength and pervasiveness. Monetary and fiscal policies operating sharply at odds since late 1979 have kept the U.S. economy in its weakest position since the Depression. Two recessions in the last three years have brought real economic output in this Nation to a point below that of 1979. Unemployment peaked at 10.8 percent in December, the highest since the dark days of 1940. Business failures in 1982 were at their highest level since the 1930s. Clearly this is not the kind of damage that can be remedied by a few short quarters of better numbers. In order to repair the damage that the recessions of 1980 and 1981–1982 caused, it is important to take steps not to ensure stable, non-inflationary growth in the future. That is why MBA is extremely disappointed in the President's fiscal year 1984 Budget. Even though the economic assumptions are probably too pessimistic, the forecast for the future is more believable than past budgets. Yet, the fact is that the budget does not make enough meaningful cuts in Federal spending, and projects immense deficits. This failure, if unremedied by this Congress, will mean that the recovery we see beginning will be short-lived and terribly disruptive to the economic well-being of American citizens.

The Administration is estimating a Federal deficit for fiscal year 1984 of nearly $200 billion, following a deficit of a similar size in the current fiscal year. The amount of borrowing that the Treasury must do to finance such a deficit is enormous. In fiscal year 1984, the Federal government may have to raise $185 to $200 billion in new cash. This means that the Federal government will absorb nearly one-half of the total new supply of credit demanded in our economy. Furthermore, the President's budget makes it clear that this situation is expected to continue through fiscal years 1985 and 1986.

These huge deficits make a strong and sustainable housing and general economic recovery highly doubtful. With the Federal government taking such an excessive share of credit, interest rates are likely to rise substantially. A renewal of higher interest rates, before the recovery is firmly in place, means even higher unemployment and business bankruptcies. Only if the Congress succeeds in reducing the Federal deficit by meaningful and substantial amounts, is there a reasonable prospect of resuming non-inflationary real growth in the American economy. It is a cruel irony that an Administration dedicated to reducing the role and presence of the Federal government in the private sector, not to mention one that promised a balanced budget in fiscal year 1984, instead remains a pervasive giant in the Nation's credit markets.

The choices facing the Congress are not easy and all of them involve sacrifices for one or more groups. We in the housing industry are more than familiar with the sacrifices that returning to a healthy economy requires. Federal spending for housing and community development has been cut by over two-thirds in the past three years.

In this Congress, the next budget move should be to examine defense spending very carefully. The Nation's security is paramount, but we believe that honest and patriotic people can differ on the costs involved, and the timing of expenditures required in attaining that security.

Similarly, all of the entitlement programs that grow automatically with every upward movement in the price indices should be structured so that no one group benefits at the expense of others. Only as a last resort should tax increases be contemplated. Any new tax should be structured so as to recognize the future benefits of reduced marginal tax rates on business and consumer savings and investment.

These suggestions are made in the spirit of cooperation and underline the seriousness of our situation. The last thing that this Nation needs is a truncated recovery and a return of recession. We have already paid too high a price in terms of unemployment and lost economic output.

It is our belief, however, that sizable cuts in Federal spending as the Nation's economy returns to health are the only way to assure that economic health will continue.

THE SECONDARY MORTGAGE MARKET

In the first three quarters of 1982, approximately 80 percent of all loans originated were purchased by secondary mortgage market investors. This trend has been

increasing in the past few years. In 1981, over 55 percent of all loans were sold in the secondary market.

This major trend in mortgage investment is caused by a wide variety of changes in the banking and mortgage finance industries. Financial institutions have recently won expanded powers. Institutions, which in the past have held mortgages as long-term portfolio investments, have been seriously affected by sustained high interest rates when their portfolios held low-interest rate loans. While the increased reliance on the secondary market is due in large part to adverse market conditions, it also has a number of market advantages. Mortgage-backed securities and participation certificates are liquid instruments that may be easily bought and sold. This attracts investors who otherwise would be disinterested in mortgage investments. In addition, when mortgages are pooled together, it is easier to tap into the capital markets because the securities are essentially equivalent to corporate or government bonds. The standardization present in mortgage-backed securities has also attracted non-traditional investors.

If we are adequately to address the future mortgage credit needs of this Nation, we must ensure the stability of the secondary mortgage market. The following sections highlight various aspects of that market.

Limitations on FHA mortgage insurance and GNMA-MBS guaranty activity

Since fiscal year 1981, Congress has imposed "credit budget" limits on the FHA mortgage insurance and GNMA-MBS guaranty programs through the budget and appropriations processes. In fiscal year 1983, Congress approved credit budget limits of $45.9 billion for the FHA mortgage insurance programs and $68.25 billion for the Government National Mortgage Association (GNMA) Mortgage-Backed Security (MBS) program. MBA supports these identical levels for fiscal year 1984.

FHA

In 1934, the FHA initiated the concept of the amortized, level-payment home mortgage loan backed by mortgage insurance in the event of default. Prior to the development of the mortgage insurance concept, mortgage lenders had required large downpayments to secure the property and to balance the risk, and demanded lump sum "balloon" payments at specified, short-term intervals. FHA, by pooling the risks attached to any one loan across large groups of loans, was able to reduce the potential cost of risk-taking with mortgage insurance.

There are four non-subsidized FHA home loan insurance programs—Section 203(b) for mortgages on one-to-four family units; Section 245 for graduated payment mortgages (GPM); Section 244 for co-insurance where the lender assumes a portion of the default risks; and, Section 213 for cooperative units. Private lenders provide all of the funds for the mortgages; FHA simply insures these mortgages against any loss associated with a foreclosure. FHA has thus fostered a strong working partnership between private lenders and the Federal government, which has provided a steady supply of mortgage credit to moderate- and middle-income homebuyers.

Borrowers under these programs pay a mortgage insurance premium that covers the costs associated with the program. The premium income is used to pay the administrative expenses of these programs, including FHA's salaries, rent, overhead, etc. The premium income is also placed in a reserve fund, which covers foreclosure expenses whenever the proceeds of a foreclosure sale are insufficient to cover the mortgage balance. Not only do the reserve funds cover expenses and losses, but there is a mutuality feature built into these funds—if a borrower pays off the loan, a dividend will be paid from the fund to the borrower.

Not only are all expenses attributable to these programs covered by user fees, but the substantial reserve funds are invested in Treasury certificates. This provides a substantial savings, because to the extent that Government borrowings are covered by this and other similar funds, the Government is not financing its own debt in the capital markets, which both reduces the Government's cost of borrowing and makes room for other types of credit users.

GNMA-MBS program.—GNMA was established in 1968, when the Federal National Mortgage Association (FNMA) was spun out of the Department of Housing and Urban Development (HUD) and accorded a private ownership status. GNMA's Mortgage-Backed Security (MBS) program was initiated soon after to introduce alternative sources of capital investment into the secondary mortgage markets. The creation of the GNMA-MBS revolutionized mortgage finance by providing a highly liquid security, which attracted traditional and non-traditional investors alike.

Under the GNMA-MBS program, lenders package FHA-insured and VA-guaranteed mortgages into "pools" and sell securities based on the loans in the capital markets to investors. A GNMA-MBS pool usually consists of loans packaged in

minimal amounts of $1 million. The program is a highly efficient one, which maximizes the involvement of the private lender and minimizes the Government role.

A lender will ordinarily contact a securities broker or dealer to arrange for a commitment for a GNMA-MBS at an agreed upon amount, based on the lender's current and anticipated production of FHA and VA loans. The securities broker/dealer is responsible for securing investors willing to purchase the GNMA-MBS. Once those loans are packaged the lender will apply to GNMA for an MBS certificate and guaranty, and issue the MBS.

A GNMA issuer is obliged to forward payments to the investor whether or not the FHA/VA borrowers have made their payments. GNMA guarantees that if an issuer is unable to forward the interest and principal to the investor in a timely manner, GNMA will make the payments to the investor on behalf of the lender.

User-fees cover all administrative and default expenditures associated with the GNMA-MBS program. The fees are also accumulated in a reserve fund to cover potential default expenditures. The reserve fund is invested in Treasury certificates, and thus represents further savings to the goverment, as explained previously in the discussion of FHA's operations. In fact, fee collections and other income are expected to exceed expenses by $185.7 million in 1984.

Fiscal year 1984 credit budget limitations.—MBA opposes setting limits on these non-subsidized, self-supporting FHA and GNMA-MBS programs. Although Congress in the past few years has imposed limits on these programs, it has been sensitive to the need to maintain a viable FHA and GNMA, so it has set these levels high enough to accommodate demands. For fiscal year 1984, MBA proposes that the credit budget levels be set at $45.9 billion for FHA and $68.25 billion for the GNMA-MBS programs. A number of factors support setting the ceilings for these programs at these levels.

Traditionally, FHA mortgage insurance has been available to any potential borrower so long as the mortgage being sought fell within the maximum mortgage amount prescribed by Congress. If restrictive limits cause a shutdown of the GNMA-MBS programs, not only will FHA originations be terminated by VA loans as well. This is because the GNMA-MBS program serves as the conduit to tap into the capital markets in order to sell the majority of both the FHA and VA loans originated. In the first three quarters of 1982, nearly 85 percent of FHA and VA loans were packaged and sold in GNMA-MBS pools. In 1981, over 70 percent of FHA/VA loans were sold via the GNMA-MBS.

Other events have increased the importance of the GNMA-MBS program in the past few years. Thrift institutions, which include savings and loan associations and mutual savings banks, have in the past originated or purchased loans to be held as long-term portfolio investments. Today, the tendency is to purchase securities backed by mortgages, because these securities are liquid and may be marketed readily. This provides a certain amount of insulation from volatile interest rate swings. Recently, thrifts and banks have experienced inflows of deposit funds, due to their expanded powers, which allowed more attractive accounts to be offered. These fund inflows will allow for more investment, but we believe, nonetheless, that the trend toward holding securities rather than mortgages will continue.

FNMA has the authority to purchase conventional loans as well as FHA/VA mortgages. In the past year, however, FNMA has sought yields above those avaiable through the sale of GNMA-MBSs. As a result, FNMA's purchases of FHA/VA loans have fallen dramatically, as indicated by the table below.

FNMA purchases of FHA/VA loans

[In millions of dollars]	*Volume*
1982	901.2
1981	2,284.0
1980	5,273.3

Formerly, FNMA provided a strong market alternative for FHA/VA loans. However, since that market has virtually dried up, the GNMA-MBS program should be given high enough ceilings to provide a sufficient supply of long-term, fixed-rate, mortgage credit. While this does not indicate that FNMA will never again purchase an FHA/VA loan, it does underscore the importance of providing an adequate credit budget level for GNMA as well as explain the upsurge in the GNMA commitments to guaranty in fiscal year 1983.

Increases in the FHA and GNMA-MBS credit budget levels will also be necessary because of increased demand for FHA programs. When interest rates fell in September 1982, demand for FHA mortgages mushroomed, so much so that the Administration had to attach to the Continuing Resolution an emergency supplemental request

for $6.1 billion for the FHA credit budget limit. HUD, in its budget proposal for fiscal year 1984 has requested $39.8 billion for the FHA programs on the assumption that demand will have decreased by then. For a variety of reasons, MBA does not believe that this will be the case.

Applications to refinance high interest rate loans have recently accounted for approximately 30 percent of FHA applications. While this demand will slack off somewhat, MBA believes that there will still be a strong demand for refinancing funds over the next few years. Seller-financing accounted for a large volume of the loans originated over the past few years. Very often, however, that financing was not long-term, but called for a balloon payment of the mortgage balance after a specified number of years, usually three, five or seven years. These balloons will continue to mature over the next few years and will require an adequate source of refinancing funds.

The FHA has always played the role of a market innovator. In this regard, HUD is expected to propose an authorization for several types of new experimental FHA programs. A new multi-family co-insurance program, a shared appreciation mortgage (SAM) program for single- and multi-family homes, and an adjustable rate mortgage (ARM) program for single- and multi-family purchasers will increase the attractiveness of FHA programs and will necessitate a higher FHA credit budget ceiling than that proposed by HUD.

Most importantly, activity can be expected to increase because of the housing recovery, if interest rates remain at or near their current levels. Demand for housing has been pent-up severely for the last three years. That fact, in addition to demographic demand attributable to new household formations, is likely to keep mortgage activity at high levels. If activity levels for estimating the credit budget limits are predicated on the performance of the mortgage finance markets in the past three years, the limits will seriously underestimate demand for the programs.

New housing starts have been far below those projected as necessary to accommodate housing demand by the "baby boom" generation that is currently reaching prime homebuying age. These potential purchasers have been frustrated in their efforts to afford a home in the past few years while interest rates have been so high. Now that interest rates have abated, it is important to have available and adequate supply of home mortgage credit if the housing needs of these families are to be addressed. In our estimation, at least 1.8 million housing starts per year will be necessary to fill that need. In the past three years housing starts have fallen far below that threshold. While it may be difficult to build and finance enough homes to make up for the past few years, it is important to ensure that mortgage credit is not artificially restricted and mortgage costs increased so as to impede the effort to gear up and at least approach the projected necessary annual levels of new housing production.

Congress should be careful not to overestimate the capacity of the suppliers of conventional funds to provide sufficient volumes of long-term, fixed-rate mortgage funds as have been provided in past economic post-recession periods. The current shakedown period in which the markets are evolving should be handled carefully so as not to create shortages of mortgage credit at a time of unprecedented demand.

Removal of mortgage loan purchase limits for FNMA and the FHLMC

MBA urges Congress to remove the maximum mortgage loan purchase limits currently imposed on FNMA and the Federal Home Loan Mortgage Corporation (FHLMC).

Currently, FNMA and the FHLMC may not purchase loans with balances greater than a legislatively determined maximum dollar amount. Although the purchase limit is indexed annually, the current limit of $108,300 effectively excludes many potential FNMA and FHLMC purchases in a significant number of high cost areas. FNMA and the FHLMC package many of the loans they purchase as securities to be sold to capital market investors and higher balance loans would be acceptable as collateral behind FNMA- and FHLMC-issued securities.

FNMA and the FHLMC have both shown a commitment to provide a source of mortgage credit for a wide range of loans—both as to type and dollar amount. The average loan amount of their purchases is significantly below the maximum purchase limit. Nonetheless, in order to maintain the ability of FNMA and the FHLMC to serve all geographic areas equally, and to expand the markets for larger balance loans that have become so prevalent in today's housing market, these restrictions should be removed. The secondary market is playing an increasingly dominant role in providing sources of investment capital for mortgage finance. Therefore, it is imperative that FNMA and the FHLMC be allowed to expand their operations to address the financial needs of purchasers with high balance mortgages. Potential

home purchasers must rely more than ever on access to long-term capital markets provided by institutions such as FNMA and the FHLMC, because thrift institutions are no longer providing adequate sources of long-term mortgage capital.

In order for FNMA and the FHLMC adequately to serve the needs of all home purchasers, the purchase limitations should be removed. This would give purchasers of higher priced homes access to competitive financing in the capital markets, allowing them, in turn, to sell their lower priced homes to families with lower incomes.

Potential developments for the secondary market

There are two developments that promise to provide additional scope to the secondary market for home mortgages. These are the so-called "TIMs" proposal being developed in the White House, and the recent ERISA class exemption rulings by the Department of Labor.

TIMs.—"TIMs" (Trusts for Investments in Mortgages) is the Reagan Administration's major housing finance initiative. TIMs is a broad deregulatory effort aimed at an amalgamation of Securities and Exchange Commission, Federal Reserve Board, Department of Labor, bank regulatory agency, Treasury, and state law restrictions that hamper the development of the private mortgage-backed securities market.

Many of the regulatory restrictions that are the main target of TIMs were first identified by the President's Commission on Housing. Some of the changes, such as the ability to sell securities on a "blind pool" basis, and qualifying private mortgage-backed securities as over-the-counter margin bonds, have already been accomplished. The Administration budget message indicated that these restrictions will be addressed in proposals for both regulatory and legislative changes in the coming year.

The central part of the TIMs initiative is a change in the Federal tax law. The new feature for TIMs, which might be accomplished either through a liberal interpretation of Internal Revenue Service rules governing the grantor trust form of MBS, or through amendments to the Internal Revenue Code, will allow internal reinvestment and provide the ability to create fast pay/slow pay mortgage-backed securities. These securities are expected to attract pension funds to the MBS market, since their selective allocation of principal can result in a substantial degree of call protection for the slow pay certificate holders. MBA and others concerned with the secondary market believe that initiatives such as TIMs can do much to broaden and strengthen the market in the future.

ERISA class exemptions.—The Department of Labor (DOL) has recently taken steps toward freeing pension funds to invest in mortgages by exercising its authority to grant class exemptions from the prohibited transactions provisions of the Employee Retirement Income Security Act (ERISA). The prohibited transactions provisions generally prohibit pension fund investments in mortgages or mortgage-backed securities originated by a mortgage lender already servicing investments for the penison fund, or otherwise being a party-in-interest to the fund.

On December 21, 1982, the DOL proposed that pension assets managed by a "qualified professional asset manager (QPAM)" may be used to purchase mortgages from almost any party-in-interest, except certain parties-in-interest who are in a position to influence the QPAM. A bank, with equity capital in excess of $1 million, an insurance company quailfied under the laws of more than one state, and an investment advisor registered under the Investment Advisors Act of 1940 may be a QPAM.

This proposed class exemption incorporates an approach to relief similar to that contained in legislation, S 1541, introduced in the last Congress by Chairman Don Nickles (R–OK) of the Senate Subcommittee on Labor, and supported in testimony by MBA in January 1982.

On January 7, 1983, the DOL made final a rule allowing mortgages secured by second as well as first liens on real estate other than multi-family to be used as support for mortgage-backed securities exempted from the ERISA prohibited transaction provisions. DOL also exempted transactions providing for forward delivery of mortgage-backed securities, if approved by a fiduciary independent of the pension fund trustees.

MBA welcomed these rulings and believes that they will encourage pension fund investment in mortgages. However, by requiring the presence of a QPAM and restricting QPAM status to banks, insurance companies, and registered investment advisors, and by excluding multi-family mortgages and requiring independent fiduciary approval, for MBS transactions, DOL continues to imply that real estate investment is a second-rate investment and a more dangerous investment than stocks or bonds, which bear no such ERISA-based restrictions. Thus, while helpful and a step in the right direction, the DOL actions should not be viewed as opening fully

the doors for pension fund investment in mortgages, and cannot be counted upon to generate a substantial favorable impact in the secondary market.

EMERGENCY MORTGAGE FORECLOSURE RELIEF

As in other recession periods, the Nation is currently experiencing a higher than normal incidence of mortgage delinquencies and foreclosures. In a non-recessionary year such as 1979, for example, the average seasonally adjusted deliquency rate, as measured by MBA's National Delinquency Survey, was 4.62 percent. Based upon the 26.4 million mortgage loans that are estimated to have been outstanding in 1979, this means that some 1.2 million of these loans had one or more late payments.

For the first three quarters of 1982, however, the average mortgage delinquency rate was 5.46 percent, a considerable increase. Since over 27 million mortgage loans were in existence in 1982, an average 1.5 million mortgage loans had late payments during 1982's first three quarters. Similarly, foreclsoure rates also grew during this recession. In the third quarter of 1979, the rate of loans being placed into foreclosure was 0.13 percent, meaning that approximately 34,000 loans nationwide were placed into foreclosure status during that quarter. In the third quarter of 1982, 0.22 percent of all loans were placed in a foreclosure category, some 59,000 loans.

The number of loans in the foreclosure inventory also grew during this period. The inventory number measures all loans in some stage of foreclosure proceedings, regardless of when those proceedings were begun. During the third quarter of 1979, this inventory number stood at 0.27 percent, meaning that approximately 71,000 loans were in some stage of foreclosure during that quarter. By the third quarter of 1982, the latest quarter for which MBA has statistics, this inventory had grown to 0.62 percent, or 168,000 loans. Unlike the foreclosure stated statistic mentioned above, the inventory of loans in foreclosure is not a seasonally adjusted number. This is not to say that the data are not valid statistically, but merely to point out that not all loans that enter the foreclosure category are sold at a foreclosure auction.

These statistics point out that during the recession of 1981 and 1982 mortgage delinquencies and foreclosures grew steadily, which was not surprising. Mortgage loan delinquencies are highly correlated with the incidence of unemployment and with family difficulties such as divorce or prolonged illnesses. Unemployment peaked during the recession at 10.8 percent. Many of these unemployed persons had been out of work for some time. We know from studies of the subject that long-term unemployment can lead to increased chances of illness and family disruptions. It is not unexpected, therefore, that this economic distress should manifest itself in mortgage delinquency and in some increase in mortgage foreclosures.

It is important to keep these data in perspective, however. Mortgages, whether in whole loan form or as backing for a mortgage security, are among the most secure forms of investment. Even at the high rates of 1982, mortgage foreclosures affect less than one percent of all outstanding loans, a very favorable record. Even those loans that are foreclosed upon or placed in HUD's assignment program have some form of loss prevention insurance. It is also important to point out that despite the increase in these statistics, our members, as well as the other major mortgage loans servicers, are doing everything that they can to prevent foreclosures. They are voluntarily exercising forebearance and working with delinquent homeowners in order to keep them in their homes and at the same time to ensure that their contractual obligations to mortgage investors are preserved.

MBA expects that mortgage delinquencies and foreclosures peaked in late 1982. Declines in mortgage interest rates and the strong recent increase in real estate activity contributed positively to easing loan delinquency problems. Recent signs that unemployment is beginning to ease strengthens this belief. It is possible that MBA's fourth quarter 1982 national delinquency data, due for release soon, will show increased levels of distress, but this will probably be the end of current increases. The best medicine for mortgage loan delinquencies is the return to strong, non-inflationary economic growth with lower unemployment. We believe that this kind of growth is just now beginning.

A number of emergency foreclosure relief bills have been introduced both in the House and Senate. These are in response to the alarming numbers of defaults and foreclosures on existing mortgages. While MBA believes that the default rate may have peaked, there is still a great deal of concern about this problem, particularly in areas experiencing continued high levels of unemployment.

While lenders seek to forebear whenever possible, particularly where the default is beyond the control of the borrower, it is costly for a lender to forebear for an extended period of time, and in many instances it is necessary to initiate foreclosure

proceedings. When lenders do not receive a borrower's payment, investors often require the lender either to repurchase the loan or to forward the payments, nonetheless. Under the GNMA-MBS program, lenders must forward both principal and interest to the investor even if no payment is received. The FHLMC under its Participation Certificate program, requires the lender to forward the interest payments only. Under FNMA's Conventional MBS program, lenders must forward both principal and interest. For whole loans, FNMA at present does not require lenders to forward interest, but soon will. These investor requirements put an enormous strain on a lender. Lenders prefer to forebear whenever the customer is deserving, particularly in cases of sudden unemployment. But they cannot afford to advance funds to investors to cover unpaid loans for indefinite periods, especially if they are servicing large numbers of loans in localities experiencing high unemployment, without recourse to some relief program.

For FHA loans, there is some relief. FHA has established procedures for handling loans in default. A borrower is considered in default when two mortgage payments are in arrears. The lender is required to notify FHA within five working days after a borrower has defaulted. The borrower is also notified about the loan's default status.

The earliest time that a lender may initiate foreclosure is after an FHA borrower has been in default for three months. FHA requires foreclosure to be started within one year of the default or 60 days after the grace period prescribed by state law. Where the property is abandoned, where the borrower has refused further payment in writing, or where the property has been rented FHA allows for accelerated initiation of foreclosure proceedings so that the value of the security will not be diminished.

HUD allows two measures to avoid foreclosure-recasting and assignment. If the default was caused by circumstances beyond the borrower's control, a mortgage can be recast, but only if the lender agrees. In recasting the unpaid principal balance of the mortgage may be increased to cover the total unpaid amount and/or the mortgage term can be extended up to ten years without HUD's approval. Where the term will be extended more than ten years, and approval is required. Under the assignment program the lender can apply for permission to assign its interest to the HUD Secretary when the defaulted borrower's situation meets certain specified conditions. However, HUD approves only about 14 percent of loans applying for coverage under this program. The HUD assignment program has thus worked to a limited degree to solve borrowers' problems.

An additional FHA relief program may begin operating soon. The Temporary Mortgage Assistance Payments (TMAP) program has been developed, and regulations have been issued in response to the need for a program less costly than the assignment program. But implementation of the program is being held up pending a review by the Federal District Court in Chicago, which has rules on the adequacy of the assignment program in the case of *Farrell* v. *Harris*, and retained its jurisdiction to review the TMAP program.

Basically, TMAP accords relief to a borrower who is unable to make payments through no fault of his or her own. The lender continues to service the loan, and JHUD forwards payments to the lender on the borrower's behalf. Funds for the program come from the applicable FHA insurance fund, but are subject to ceilings established by appropriations acts. Thus, no funds need be actually appropriated, but the actuarial soundness of the insurance funds can be protected by the appropriations ceilings established by Congress. The efficacy of this program will remain untested until it is implemented. MBA has urged HUD to move as quickly as is legally possible in light of the emergency situation that exists due to the high levels of FHA mortgages in default.

The TMAP program, even when it is eventually implemented, will do nothing to address the problems of VA guaranteed or conventionally insured borrowers. If default rates continue at the present levels, and lenders are forced to foreclose on a large number of homes, the value of homes could be seriously affected, particularly in areas suffering from high concentrations of unemployment.

In light of the serious situation that is developing, MBA encourages this Committee to consider the various proposals that have been introduced that would provide relief for VA and conventional borrowers. In this vein, MBA would like to make several suggestions to Congress on the framework of an emergency foreclosure relief measure.

The trigger for such a program should be based on regional or local data, rather than on national statistics. Recent foreclosures have been concentrated in areas experiencing high unemployment. While national statistics may not trigger activating an emergency foreclosure assistance program, local conditions in many regions

could warrant implementation. Even if a national trigger is employed, the program should focus what will undoubtedly be limited resources on regions with high unemployment problems.

MBA believes that any assistance payments should be recapturable. Payments on a borrower's behalf should be secured by a second lien against the property to ensure repayment. Also, assistance under a foreclosure relief program should not be extended for too lengthy a time period.

MBA has another specific suggestion regarding the VA program. The Omnibus Reconciliation Act of 1982 (P.L. 97-253) required VA borrowers for the first time to pay a funding fee of one-half of one percent at settlement. This was the first time that a user-fee was imposed for VA borrowers. This fee, however, is paid into the U.S. Treasury. MBA, in its comments on the funding fee, had unsuccessfully urged that the funding fee be paid into the VA Revolving Loan Guaranty Fund to offset administrative and default expenses attributable to the program. In the same manner that TMAP can tap into the reserves of the Mutual Mortgage Insurance Fund for foreclosure assistance payments, veterans in trouble should be allowed to utilize reserves accumulated from the user-fees that they have paid. MBA, therefore, urges that the VA funding fee authorization should be amended to allow for those fees to be paid into the VA revolving loan guaranty fund. Otherwise, the VA Revolving Loan Fund runs the risk of becoming seriously depleted. The projection for February 1983 is that the fund will contain $120 million subject to that month's expenditures totalling $75 million.

As Congress reviews the alternatives for structuring a foreclosure relief program, MBA would like to cooperate to the utmost and to offer background information as needed.

FHA PROCESSING OF LOAN APPLICATIONS

Direct endorsement program

HUD has recently issued proposed regulations delineating the Direct Endorsement Program. This program will give participating lenders the option of performing their own underwriting evaluations, in order to expedite the loan application process. The objective of the program is to shorten the process of receiving an endorsement for mortgage insurance for FHA loans. The program has been tested under a demonstration known as the Delegated Processing Program in a number of target cities that has been operating successfully since its inception in 1979. Both lenders and HUD have been generally pleased with the results of the Delegated Processing Program.

Particularly in light of the excessive backlog created when interest rates fell precipitously in the fall of 1982, MBA would like to applaud HUD for its efforts to develop the Direct Endorsement Program, which is expected to be implemented by April 1983.

FHA application backlog

Until the Direct Endorsement Program is implemented, however, the mortgage industry must still cope with the substantial backlog in application reviews. The FHA has been experiencing unprecedented levels of activity ever since interest rates declined in the early fall of 1982. This has resulted in application backlogs and substantially extended the time for FHA review. While MBA is obviously concerned about the situation, we believe that HUD is doing its best to reduce the backlog.

HUD has taken a series of administrative steps to streamline FHA loan application procession. These include: Hiring fee-paid clerical and underwriting personnel; shifting staff from other departments to process single-family mortgage loan applications; shipping applications to other HUD field and regional offices for processing; reducing the number of required field reviews of HUD appraisals; and increasing maximum appraisal fees if the field office believes such an increase is necessary to attract an adequate number of appraisers.

While these emergency measures are designed to cope with the present situation, only implementation of the Direct Endorsement program can prevent a similar situation from developing in the future.

FHA NEGOTIATED INTEREST RATE PROGRAM

One particular FHA program that has proven very popular in the last several months is the authorization of negotiated interest rates for FHA Section 203(b) loans. Under this program, borrowers and lenders negotiate the interest rate on FHA-insured loans and the lender must commit to that rate for 30 days. However,

the number of loans that can carry a negotiated rate is limited to 50,000 loans, or 10 percent of the previous year's FHA volume, whichever is greater, and that limit will probably be reached within six weeks. MBA supports the removal of all controls on FHA interest rates and discount points. However, until Congress takes this step, MBA urges the removal of the volume limit on the number of FHA loans that can be included in the negotiated interest rate program.

Thank you for the opportunity to testify. MBA will be happy to answer any questions you may have.

JAMES M. WOOTEN, PRESIDENT, MORTGAGE BANKERS ASSOCIATION

Mr. WOOTEN. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, my name is Jim Wooten. I am president of the Lomas & Nettleton Co., the largest mortgage banking company in this country, and I currently serve as president of the Mortgage Bankers Association of America.

RECOVERY NOT OF NORMAL STRENGTH AND DURATION

The American economy is finally emerging from its worst recession since the Great Depression. Unfortunately, the economic recovery is not likely to be of normal strength and duration, because current and projected Federal budget deficits in the $200 billion range will choke off that recovery unless they are reduced substantially. MBA strongly supports congressional attempts to reduce the Federal deficit in fiscal year 1984 and the years to come. Cuts in the growth of defense spending and entitlement programs, including social security, are absolutely essential, and tax increases may also be necessary after the spending cuts are achieved.

Focusing specifically upon the housing and mortgage finance industries, the future mortgage credit needs of this Nation increasingly must rely upon the growth and efficiency of the secondary mortgage markets. In this vein, we have a number of suggestions to offer.

Of perhaps the greatest significance, MBA urges the Congress to continue its strong support of the FHA mortgage insurance program and the GNMA mortgage-backed security program. For fiscal year 1984, we recommend credit ceilings at least as high as those set for this year—$5.9 billion for FHA and $68¼ billion for GNMA. FHA needs ceilings at least this high for several reasons—to meet the continued strong demand for refinancing; to serve the needs of home buyers unable to afford the high interest rates of recent years; to satisfy the burgeoning demands of younger, first-time home buyers; and, to accommodate new programs proposed by HUD, including a multifamily coinsurance program and a new adjustable rate mortgage program.

High ceilings are equally important for the GNMA mortgage-backed security program, because it provides access to capital market sources of funds for the vast majority of all FHA and VA mortgages originated. In the first three quarters of 1982, for example, nearly 85 percent of all FHA and VA loans were sold into the secondary markets through GNMA mortgage-backed securities.

Turning to another critical aspect of the secondary mortgage markets, FNMA and FHLMC currently are limited in their activities by ceilings of $108,300 on the size of individual loans they may purchase. MBA urges the outright removal of these limitations to

allow FNMA and FHLMC to be able to serve all markets across the country and to expand the availability of credit for larger balance loans, which have become common today.

MBA also urges the Congress to consider favorably the broad deregulatory initiatives of the administration with respect to conventional mortgage-backed securities, known as the TIM's proposal, or trusts for investment in mortgages, and attempts to ease the restrictions on pension fund investments in mortgages that arise from ERISA legislation. If these initiatives meet their objectives, they will broaden substantially the ability of the secondary mortgage markets to provide affordable credit to this Nation's home buyers.

Mortgage bankers are deeply concerned about the high level of mortgage delinquencies and foreclosures currently resulting from the sustained high unemployment levels in this country. We believe that these problems have already peaked, however, and will begin to recede during 1983. Recent declines in mortgage interest rates and the tremendous resurgence in real estate activity have already begun to alleviate these problems, and reductions in unemployment as the recovery gets underway should further improve this situation.

MORTGAGE ASSISTANCE PROGRAM

Nonetheless, a significant problem still remains, and we are aware that the Congress is considering a variety of proposals to provide mortgage assistance to those in trouble. Mortgage lenders, for their part, have been practicing forbearance and counseling homeowners extensively, but lenders, too, must be concerned for their own survival, so they cannot practice forbearance for indeterminate periods.

Therefore, if the Congress does decide to adopt a mortgage assistance program, MBA could support such a program with certain features designed to increase its cost effectiveness. We would urge that the trigger for such a program should be based on regional or local data, probably unemployment statistics, because delinquency and foreclosure problems have been concentrated in areas of higher-than-average unemployment. Further, to minimize the pressure on Federal spending, the mortgage assistance payments should be recapturable, and should be extended for relatively short periods of time, such as 12 to 18 months.

In closing, let me mention FHA's negotiated interest rate program, which permits borrowers and lenders to negotiate interest rates without regard to the maximum FHA rate administered by the Secretary of HUD. This program has been highly successful as an experimental approach to freeing the FHA rate from all controls, an ultimate objective that MBA strongly supports. Until the Congress finally frees the FHA rate from administrative controls, however, MBA respectfully requests that Congress remove the limit of 50,000 loans on the negotiated interest rate program. With the tremendous surge in demand for loans under this program, the 50,000 loan limit will soon be reached, and the program shut down.

We thank you, once again, for the opportunity to testify.

The CHAIRMAN. Thank you, Mr. Wooten. Once again, as I said earlier, your full statement will be printed in the record. We appreciate your summary. And now, Mr. Gray.

STATEMENT OF HERBERT GRAY, PRESIDENT, MUTUAL SAVINGS BANK ASSOCIATION

Mr. GRAY. Mr. Chairman and members of the committee, my name is Herbert W. Gray. I am chairman of the National Association of Mutual Savings Banks and chairman of the Mutual Bank for Savings in Boston, Mass.

I appreciate the opportunity to appear before this committee to discuss the prospects for the housing industry. As indicated in greater detail later in this statement, we believe that:

Short-run prospects for a housing recovery are highly favorable, although the expansion in 1983 will fall far short of previous peak years.

Longer run prospects for a sustained housing expansion beyond 1983 are in greater doubt and depend critically on efforts to reduce projected Federal budget deficts. In a more stable financial environment, and as a result of the Garn-St Germain Depository Institutions Act, thrift institutions will undoubtedly resume their significant mortgage lending role.

The process will take time, however, because of the weakened condition of thrift institutions and the need to absorb the costs of deregulation and to restructure existing assets.

While recovery is certainly in progress, the magnitude of the 1983 increase in housing activity will be limited in our view by a number of unfavorable factors. High unemployment will have a dampening effect on consumer buying plans, even though more families will be able to afford to buy homes. Mortgage interest rates, while below recent peaks, will still be high by earlier standards. Furthermore, thrift institutions will have to continue to maintain strong emphasis on liquidity, and this will hold down the expansion of mortgage credit.

OUTLOOK CLOUDED BY UNCERTAINTIES

In contrast with short-run prospects, the longer run outlook is clouded by uncertainties. A number of obstacles will have to be overcome if the Nation's expanding housing needs are to be met in the years beyond 1983. Chief among these is the prospect that high mortgage interest rates and restricted mortgage credit availability may periodically keep many families out of the market, families which regard good housing as a birthright. As a result that would also have grave social and political implications.

High expectations of good housing by all generations are more important than statistics and surveys and probably represent a real political timebomb ticking away.

The most important action that can be taken to meet the Nation's long-run housing needs is to reduce projected Federal deficits. Such action would alleviate unfavorable financial market expectations, which are helping to keep long-term interest rates relatively high.

Treasury borrowing would be reduced, thereby diminishing the risk of housing, and other private sectors being crowded out of the marketplace.

Unless currently projected Federal deficits are reduced in future years, in our view, interest rates are very likely to remain at levels that will make a sustained longer run housing recovery impossible, regardless of the mechanics, the laws, the techniques or type of investment involved.

Within the context of efforts to reduce budget deficits, serious consideration should also be given to tax changes that would encourage an enlarged flow of private savings. An increase in private savings, particularly long-term savings like IRA's and Keogh accounts, help to generate the capital this country so badly needs for a variety of purposes, including housing.

LIBERALIZATION OF THE IRA PROGRAM

As indicated in our full statement, further liberalization of the IRA program and a variety of other tax measures may well be needed to stimulate increased private savings, consistent with the urgent need to decrease Federal budget deficits. If the budget can be brought under control, longer run prospects for housing will be greatly enhanced. This will be especially true, in view of the improved condition of the Nation's thrift institutions, savings banks and savings and loan associations, which traditionally have been a major source of housing credit. The condition of our industry has clearly taken a turn for the better. The chief reasons are the sharp decline in interest rates last year and the enactment of the Garn-St Germain Depository Institution Act of 1982.

If the current improvement continues, savings banks will gradually be able to increase their mortgage lending activity. It must be expected, however, that savings banks will continue to place strong emphasis on maintaining liquidity, especially because of major shifts in their deposit structure toward the new money market deposit accounts.

Savings banks will also continue to be burdened by large holdings of low-yield, long-term mortgage loans which will depress their earnings and restrict their ability to compete for savings for some time to come.

I think it is important to recognize that problem is still with us, the basic problem the thrift industry has had through all this period. Furthermore, the new money market deposit accounts and other deregulation actions will slow down the return to profitability that otherwise results in reduced interest rate levels.

The savings bank industry has a long way to go before it can completely regain itself.

We expect, however, that these short-run problems will eventually recede and thrift institutions will be in a position to resume a stronger role in the longer economies. The long-run benefits of the Garn-St Germain Act become increasingly evident in conjunction with the important changes in mortgage instruments and markets in recent years. That act provides the framework for a strengthened system of home finance in this country.

Improvements in the mortgage instrument itself, mortgage-backed securities, including the question of protection for investors and other improvements and expansions of the mortgage markets will also attract new funds for housing from a much more diversified group of lenders and investors. Broadening the source of mortgage supply could be one of the best things that could happen to housing.

Clearly, low and stable interest rates are the prequisite for helping housing markets, but the strength and flexibility of mortgage markets and institutions are also of critical importance. And in this respect, the strengthened thrift industry that will result from the Garn-St Germain Act is a major step forward for housing.

I hope these comments will be helpful to the committee.

Thank you for the opportunity for presenting them.

The CHAIRMAN. Thank you, Mr. Gray.

[Complete statement follows:]

STATEMENT OF THE NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS ON THE HOUSING INDUSTRY OUTLOOK

Mr. Chairman and members of the Committee, my name is Herbert W. Gray. I am Chairman of the National Association of Mutual Savings Banks and Chairman of the Mutual Bank For Savings in Boston, Massachusetts. The National Association represents the 420 savings banks in the nation. Savings banks are basically community-oriented financial institutions. In the areas where they are most heavily concentrated, savings banks are the largest holders of consumer savings as well as the dominant mortgage lenders among the various types of depository institutions. The industry's assets total $175 billion.

I appreciate the opportunity to appear before this Committee to discuss the prospects for the housing industry. As indicated in greater detail later in this statement, we believe that:

Short-run prospects for a housing recovery are highly favorable, although the expansion in 1983 will fall far short of previous peak years.

Longer-run prospects for a sustained housing expansion beyond 1983 are in greater doubt and depend critically on efforts to reduce projected federal budget deficits.

In a more stable financial environment, and as a result of the Garn-St Germain Depository Institutions Act, thrift institutions will undoubtedly resume their significant mortgage lending role.

The process will take time, however, because of the weakened condition of thrift institutions and the need to absorb the costs of deregulation and to restructure existing assets.

SHORT-RUN HOUSING OUTLOOK

With respect to the short-run outlook, there seems to be general agreement among forecasters that the housing industry is poised for a significant recovery during the remainder of 1983. Indeed, housing starts and sales are already on the upswing in response to an improved overall financial climate. Reductions in mortgage interest rates have brought housing costs within the reach of an increasing number of potential home buyers, and enabled more borrowers to quality for credit. At the same time, the availability of mortgage credit has begun to expand. A basic underlying stimulus is the backlog of deferred demand, following three years of depressed activity.

The upturn in housing activity is expected to continue as 1983 progresses. This is predicated, of course, on the expectation that interest rates will remain reasonably close to current levels throughout most of this year, or at least will remain much lower than earlier peaks. Such an interest rate climate is anticipated by many observers, in view of the prospect that the overall economy will experience only a moderate recovery and that inflation will remain subdued in 1983.

While a recovery is clearly in process, the magnitude of the 1983 increase in housing activity will be limited by a number of unfavorable factors. High unemployment will have a dampening effect on consumer buying plans, even though more families will be able to afford to buy homes. Mortgage interest rates, while below 1981-82 peaks, will still be high by earlier standards. Furthermore, thrift institutions will

have to continue to maintain strong emphasis on liquidity, and this will hold down the expansion of mortgage credit.

Balancing the favorable and unfavorable factors, it appears that this year's housing recovery, while significant and overdue, will fall far short of previous boom periods. According to NAMSB staff projections, housing starts will increase to about 1.4 million units for 1983 as a whole. This will be substantially higher than the 1.1 million units started in 1981 and in 1982. However, it will still leave housing activity well below the 2 million-plus level achieved in earlier record years. As a result, housing activity will remain below the levels which were once considered the minimum necessary to meet the nation's housing needs.

LONGER-RUN PROSPECTS

In contrast with short-run prospects, the longer-run outlook is clouded by uncertainties. In this regard, there is no doubt that housing needs will expand in the 1980s. Population growth will be relatively rapid in this decade. Changes in the age composition will also generate additional housing needs. And this will be augmented by the backlogs resulting from depressed construction and sales in the past three years.

If these expanding housing needs are to be met in the years beyond 1983, a number of obstacles will have to be overcome. Chief among these is the prospect that high mortgage interest rates, and restricted mortgage credit availability, may periodically keep many families out of the market—a result that would have grave social and political implications. The massive federal budget deficits that loom ahead for several years will continue to exert upward pressures on the entire interest rate structure. Indeed, a major interest rate upsurge from current levels cannot be ruled out, particularly when the overall economy recovers and business and other credit demands increase on top of burgeoning Treasury financing.

At the same time, accelerated deposit interest rate deregulation will mean that rates paid by mortgage borrowers will no longer benefit from lower rates paid to savers. Housing will have to compete head on with other sectors of the economy for the available supply of funds, and this will also tend to keep mortgage interest rates higher than in the past.

In addition to the interest rate question, other potential problems may stand in the way of a sustained, long-run housing expansion in the decade of the 1980s. High levels of unemployment, if they persist, would keep consumers cautious about spending on big-ticket items, including housing. Home purchases may also be restrained by the fact that real estate values will probably not increase as rapidly in the 1980s as in the past, thereby reducing the attractiveness of housing as an investment.

While such non-interest rate problems are important and cannot be ignored, it is the prospect of periodically high interest rates that presents the chief hurdle to the long-run health of the housing industry. In our view, the most important action which can be taken to meet the nation's housing needs is to reduce projected federal deficits in the years ahead. Such action would alleviate unfavorable financial market expectations which are currently keeping long-term interest rates relatively high in the face of economic recession and reduced inflation. Treasury borrowing would be reduced, thereby diminishing the risk that the housing sector and other private borrowers will be crowded out of the financial market place. As noted earlier, reduction in deficits will be particularly crucial as the economy and private credit demands revive. Unless currently projected federal deficits are reduced in future years, interest rates are very likely to remain at levels that will make a sustained, longer-run housing recovery impossible.

Within the context of efforts to reduce budget deficits, serious consideration should also be given to tax changes that will encourage an enlarged flow of private saving. An increase in private saving would generate the capital this country so badly needs for a variety of purposes, including housing. For this reason, our industry was in the forefront of those who supported the liberalization of the Individual Retirement Account program in the 1981 tax legislation. In our judgment, the direct and indirect benefits of the IRA program in the years ahead will far outweigh any initial adverse impact on revenues. Further liberalization of the IRA program, and a variety of other tax measures, may well be needed to stimulate increased private saving consistent with the need to reduce federal budget deficits.

Specifically, we recommend that the IRA program be revised by: (1) increasing the additional deduction for a non-working spouse from $250 to $1,000; (2) permitting a working couple filing a joint return to split the current maximum $4,000 combined

deduction between their separate IRAs in any manner they choose; and (3) providing for full FDIC and FSLIC deposit insurance for IRAs.

CONDITION AND PROPECTS OF SAVINGS BANKING

If the budget can be brought under control, longer-run prospects for housing will be greatly enhanced. This will be especially true in view of the improved condition of the nation's thrift institutions—savings banks and savings and loan associations—which traditionally have been the major source of housing credit. Eventually, thrift institutions will be able to resume a significantly strengthened role in financing the nation's housing needs.

With respect to savings banks, the condition of our industry has clearly taken a turn for the better. After the massive losses sustained in 1981–82, deposit and earnings trends have strengthened and further improvement is in prospect in the remainder of 1983. The chief reasons for the improved outlook for savings banking are: (1) the sharp decline in interest rates late last year; and (2) enactment of the Garn-St Germain Depository Institutions Act of 1982.

If this improvement continues beyond the near-term, savings banks will gradually be able to increase their mortgage lending activity, particularly as adjustable rate mortgage contracts gain increased acceptance among borrowers. For the time being, however, it must be expected that savings banks will continue to place primary emphasis on maintaining strong liquidity in response to major uncertainties in the financial market outlook. Furthermore, savings banks will continue to be burdened by the deadweight effect of their large holdings of low-yield, long-term mortgage loans acquired in earlier periods. These fixed-rate holdings will continue to have a depressing effect on the earnings of savings banks and their ability to compete for savings.

On the deposit front, the turnaround in the fortunes of savings banking has primarily reflected the recent reduction in interest rates and the surge of funds into the new money market deposit account authorized by the Garn-St Germain Act. The impact of MMDAs has been especially dramatic:

Following 27 consecutive months of deposit outflows, totaling $27 billion, savings banks have experienced two back-to-back months of deposit growth of about $2 billion in December and January combined.

The deposit improvement was accompanied by a flood of funds into MMDAs at savings banks, amounting to $14 billion from December 14 to January 11. This was far greater than the volume of funds gained in comparable periods by all other types of new accounts introduced in recent years. The bulk of MMDA growth reflected internal transfers from other types of accounts, although significant new money was also attracted from outside the industry.

The more recently authorized Super NOW accounts have also contributed to the strengthening in deposit trends, although to a much lesser extent. About $700 million were channeled into these accounts at savings banks in the first week following their introduction on January 5.

A slowdown in the growth of money market deposit accounts can be anticipated as the exceptionally high introductory rates are brought more closely in line with actual market yields. However, unless interest rates escalate too soon, savings banks should be able to hold on to the MMDA funds attracted so far, as well as draw some further new money into these accounts. Deposit insurance and ready access to funds through widespread banking offices make the MMDA attractive to many savers relative to money market mutual funds.

On the other side of the coin is the increase in costs and renewed pressures on bottom-line income positions resulting from internal transfers from passbook savings and other lower-rate accounts into MMDAs. In this regard, passbook savings still represent about 30 percent of total savings bank deposits. MMDAs offer a closer substitute to passbook savings than other deposit instruments introduced by savings banks in recent years and are likely to accelerate attrition of these lower rate deposits.

The new money market deposit accounts, therefore, will slow down the return to profitability that would otherwise result from reduced interest rate levels. Because of the continuing impact of current low-yield mortgage holdings, the savings bank industry has a long way to go before it can completely regain its health. A prolonged period of reduced interest rates is required to generate increased earnings and rebuild depleted net worth positions. In 1981 and 1982, the industry sustained devastating bottom-line losses aggregating $2.7 billion. As a result, net worth positions were drastically reduced, resulting in the forced merger of a number of institutions. Together, with the net worth certificate program provided by the Garn-St

Germain Act, the improvement in earnings will gradually restore capital positions, although the process will take considerable time.

The new money market accounts will also have major effects on the deposit structure. An increased share of total deposits will be shifted into a potentially more volatile form. While it remains to be seen how stable or unstable MMDAs will be in actual practice, savings banks currently have little choice but to maintain a cautious investment posture toward these accounts. Most savings banks are likely to invest MMDAs in short-term assets until the degree of volatility of the new account becomes clearer.

Under these circumstances, an early return to exuberant mortgage lending by thrift institutions is extremely unlikely even though some modest increase may result from improved deposit flows. The weakened condition of thrift institutions, together with the basic uncertainties they face, will place a premium on efforts to strengthen liquidity, earnings and net worth positions. In the short-run, these factors will place real limits on the ability of savings banks to participate in a major expansion in mortgage lending.

THE GARN-ST GERMAIN ACT AND HOUSING

In time, however, we expect that present short-run problems will recede and thrift institutions will be in a position to resume a stronger role in mortgage markets. As this occurs, the long-run benefits for housing of the Garn-St Germain Act will become increasingly evident. For this landmark financial institutions legislation clearly is also a major positive development for housing. In conjunction with important changes in mortgage instruments and markets of recent years, the Garn-St Germain Act provides the framework for a strengthened system of home finance in this country.

With adoption of the Garn-St Germain Act, all of the major elements of an improved housing credit system are now in place—thrift industry restructuring, together with an array of flexible mortgage instruments and increasingly efficient secondary mortgage markets. As a result of the Garn-St Germain Act, thrift institutions will be significantly strengthened, once they have implemented their new powers, and have had time to restructure their assets and absorb the costs of shifting fully to a market-linked deposit structure. Their new asset and service powers will eventually increase earnings and strengthen their ability to attract savings on both a price and service/convenience basis. Thus, thrift institutions will be more competitive over the entire interest rate cycle. As we have noted, money market deposit accounts have already contributed to a dramatic deposit turnaround, although at high cost.

In the longer-run, an increased flow of savings into thrift institutions can only benefit housing. While broader powers and resulting asset diversification may reduce mortgage-asset ratios somewhat over time, mortgages will remain highly attractive investments for most thrift institutions, either to hold in portfolio or to sell to others. The availability of more interest-rate-sensitive mortgage instruments, access to highly efficient secondary mortgage markets and their long-standing mortgage lending expertise will be strong forces to keep thrift institutions in the home financing business, although participation will necessarily vary considerably among individual institutions.

Improvements in the mortgage instrument and mortgage markets will similarly attract new sources of funds for housing, as the increased liquidity and marketability and the relatively attractive yields of mortgages become more widely appreciated by a more diversified group of lenders and investors. This will more than offset any likely diversification out of mortgages by thrift institutions. Broadening the sources of mortgage supply would be one of the best things that could happen for housing.

In sum, fears that broadened asset powers for thrift institutions will hurt housing are far off the mark. On the contrary, the new powers and competitive strength provided by the Garn-St Germain Act will benefit housing by promoting a larger and more stable flow of housing credit than would otherwise occur.

Clearly, low and stable interest rates are the prerequisite for healthy housing markets. But the strength and flexibility of mortgage markets and institutions is also of critical importance. And in this respect, the strengthened thrift industry that will enventually result from the Garn-St Germain Act is a major step forward for housing. Once the necessary short-term adjustments are made and the transition to new powers and deposit deregulation is completed, the stage will be set for significant thrift industry support for housing over all stages of the interest rate cycle.

I hope these comments will be helpful to the Committee.

The CHAIRMAN. And, now, Mr. Kendall.

STATEMENT OF LEON T. KENDALL, PRESIDENT, MORTGAGE INSURANCE COMPANIES OF AMERICA

Mr. KENDALL. Thank you, Mr. Chairman. My name is Leon Kendall, and I appear before you as president of the Mortgage Insurance Companies of America, a trade association representing the Nation's private mortgage insurance companies.

In 1982, our industry insured approximately 316,000 home loans, about one for every five loans made in the Nation, and about 59 percent of all high-ratio loans, which includes the FHA and VA categories.

I am also the chairman of the Mortgage Guarantee Insurance Corp. of Milwaukee, Wis., the Nation's largest mortgage insurer.

I have prepared a formal statement, Mr. Chairman, and I do ask that it be included in the record.

The CHAIRMAN. It will be. And may I also state that Senator Proxmire is sorry he couldn't be here to be with you, but he is chairing the hearing of the Joint Economic Committee.

Mr. KENDALL. We believe recovery is under way in the American economy and that housing is and can continue to play a prominent role in helping sustain that recovery.

Starting last September, applications for insurance among our member companies began running well ahead of a year ago levels, and the pace of gain has continued through January. It is now running over 100 percent ahead of a year ago levels.

POTENTIAL HOME BUYERS ENCOURAGED

Lower interest rates were doing the job. Potential home buyers, disqualified by the rise of mortgage interest rates, as they moved from 10 percent to 16 percent between 1979 and 1982, were brought back to the market by the lower rates.

An exhibit in my formal testimony, which appears on page 4 of that testimony, illustrates the power of those lower rates. As rates rose from 10 percent to 16 percent, the monthly payment for the same $60,000 house grew from $474 per month to $726 per month. The number of households which could qualify at 10 percent, but not at 16 percent, totaled 15 million.

As rates declined, the opposite is true. Affordability returned to over 8 million households. Late last year, as mortgage rates dropped from their conventional loan peak of 16.4 percent to today's 13.4 percent, a drop to 12 percent will bring back another 2.3 million potential buyers. The gains, however, are fragile. Any reversal in the trend of mortgage rates could shutoff housing activity all too quickly. If, through a combination of monetary and fiscal policy, we can create an environment in which rates can continue downward, housing can and will keep this recovery going, and it can do the job without reigniting the fires of inflation.

I would note that this is the first down cycle in recent memory, in which we have not to this point primed the pump by throwing Federal—special Federal housing programs at a recession.

Let me make one further point regarding the nature of this recovery. In 1982, one to four family mortgage originations totaled $90 billion. In 1983, with housing starts estimated to be between 1.3

and 1.4 million units, we expect mortgage originations to be up about 33 percent to $120 billion. So far, so good.

But there is a new factor at work in the demand for mortgage funds, and that is, as a number of witnesses have mentioned previously, the refinancing of existing mortgages. During the past 3-years under the stress of high rates and the absence of long-term funds thousands of households bought and sold homes with 3 and 5-year balloon mortgages, escalator mortgages, second mortgages, bridge loans, land contracts, and all kinds of temporary arrangements.

As soon as they can afford it, they will refinance into more affordable long-term loans.

HUD and others report about 30 percent of the loans being made today are refinancing. This is new to housing. It is an element of demand not present in earlier cycles.

We have to work through the problem. We have to straighten out the bad or weak loans. I believe there is as much as $100 billion of such financing, and every time mortgage rates drop a half percent, more of it will come into the market. Thus home-lending rates are going to be sticky on the down side, and the spread between Treasury's and AAA corporates and home mortgages will widen. The FHA loan represents—because it represents the lowest rate, fixed rate contract, has been the recipient of a large number of those refinanced contracts. This is another reason why the housing recovery is likely to be gradual rather than exuberant.

Delinquencies and foreclosures will be slow in curing, tracking the trends in unemployment, more than any other factor. The general level of interest rate as it translates into affordability and availability of mortgage funds, will call the tune on 1983 in our field.

Given this scenario, we have two specific recommendations to the committee that cry out for immediate attention.

RECOMMENDATIONS

First, the recent decline in interest rates has produced an extraordinary increase of loan applications at FHA offices. Volumes has more than tripled, as the Secretary noted, from an annual rate of 350,000 loans last summer to over 1.8 million today. Delays in processing of 60 days and more are being reported. These delays translate into houses not being built, and jobs not being filled. Early and efficient processing of these backlogs would do a great deal to get people to work and keep housing moving.

In addition, the Agency is coming close to its legislative authority to provide insurance coverage in fiscal 1983. The private mortgage insurance industry has the operational ability and financial capacity to overcome these backlogs and can begin the task within 30 to 45 days.

We propose that the FHA be authorized to enter into a reinsurance agreement with the private mortgage insurance companies of this Nation, enabling us to provide our standard product, insurance of the top 20 percent or 25 percent of loans up to 95 percent of that value to the FHA. This means we would reimburse the FHA for that portion of the loss on any defaulted contract.

In most cases, that would take care of most of the loans. In addition and most importantly for right now, it would place at the disposal of the FHA our 260 underwriting offices serving all 50 States, our claims-processing ability, and our financial reserve. Since we already serve virtually all the customers served by FHA, the program could be operational with minimal red-tape. FHA would avoid having to hire added personnel or increase its expense budget.

If the surge of volume were to decline after one year, it could cancel the contract. Our price is typically, about 50 percent of premiums charged by the agency, so their reserves and earnings actually should increase. In addition the agency could write 20 percent more business without coming back to Congress for added authority.

A second and final point deserving immediate attention is the loss of homes by unemployed and underemployed workers. In our business we call 1982 the "Year of the Claim." We also recognize that foreclosures are a lagging element in any recovery and will be with us for some time.

However, if in fact recovery is underway, then we would be well advised to do all we can to keep deserving borrowers with good prospects for reemployment in the homes they now own.

Risk-management professionals in our industry are convinced that deserving homeowners who are temporarily unemployed will fight to protect their homes if given a chance. In one test by my company, working with 230 seriously delinquent borrowers in Cleveland, we found that through counseling and refinancing of loans we achieved a 75 percent success ratio in reinstating delinquent mortgages without foreclosure; terms were developed that both the lender and borrower could live with.

Other companies in our industry have had comparable success stories to tell. Given the pressures on deficits and budgets, we would view those legislative proposals that avoid outright federal cash payments as likely to be more efficient and a more practical way to do the job. The key in any effort would be reliance on the private sector, especially the enthusiastic participation by lenders.

It will also require that lenders should remain the front-line of contact with delinquent borrowers, and their important relationship with borrowers cannot be overlooked in any program that is developed. The various responsibilities of all parties should be clear, especially regarding the canceling of borrowers and determining how the various parties at interest are to participate.

We offer our expertise as risk-management professionals in developing practical definitions that have been tested and will work in the marketplace.

[Complete statement of Mr. Kendall follows:]

STATEMENT OF LEON T. KENDALL, PRESIDENT, MORTGAGE INSURANCE COMPANIES OF AMERICA [1]

Mr. Chairman and Members of the Subcommittee, my name is Leon T. Kendall and I appear before you as President of the Mortgage Insurance Companies of

[1] MICA consists of thirteen domestic private mortgage insurance companies and one Canadian company whose insurance-in-force on december 31, 1982 was $124.97 billion. The national offi-

Continued

America, a trade association of private mortgage insurance companies. Our industry insures 1-4 family mortgage loans, enabling individual homebuyers in fifty states, Puerto Rico, the District of Columbia and Canada to purchase homes of their own with minimal down payments.

I appreciate the invitation to present my views and the views of the mortgage insurance industry to this Subcommittee. The magnitude of the changes occurring in mortgage finance and the degree of distress visited on homebuyers, home owners, mortgage lenders, realtors and builders during the recent recession warrant the careful attention of this subcommittee. The events of the past ten years, culminating in the extreme stress of the recent recession have changed dramatically and permanently the mortgage finance mechanisms.

James Russell Lowell, the New England poet, once said, "New times demand new measures and new men, The world advances and in time outgrows Things that in our father's day were best; And doubtless, after us, some purer scheme will be shaped out by wiser men than we."

In few areas is this thought more appropriate than in mortgage finance and the industries which serve it. The mortgage market is the nation's largest capital market. To this point, it has been essentially a local and decentralized market. In the years ahead this will no longer be true. The wedding of local mortgage markets and the nation's capital markets is well underway.

In my presentation, I will attempt to accomplish two tasks. First, give you our views of the current housing outlook and, second, make some recommendations so that together private enterprise and public policy might efficiently and effectively house another generation of Americans on a safe, sound and sustainable basis. I am also including as part of this testimony an analysis that will set the events of the past ten years in perspective so that members of the committee might better understand the challenge before those of us in the mortgage finance field.

CURRENT OUTLOOK FOR HOUSING AND MORTGAGE FINANCE

Homebuilders in 1982 started construction on 1.1 million new units for the year. This was the lowest total since 1946. The low point of activity occurred in the fourth quarter of 1981 and a pickup began late in the third quarter of 1982. By the fourth quarter the level of housing activity was just under 1.3 million starts. Such gains have continued into 1983.

In terms of mortgage lending activity, the gains have been even stronger. The decline of home mortgage interest rates from a peak of 16.4 percent for conventional loans in Novermber 1981 to 13.25 percent today has enabled builders, realtors and lenders to qualify a growing number of households for a home loan. Affordability is being returned to the market by lower rates. The Exhibit below indicates one measure of the impact of lower rates on housing demand. Just as rising rates removed buyers from the market, so too, falling rates can bring them back, provided consumer confidence is there. For example, a decline from 16 percent to 12 percent means over 9 million additional households are able to afford a $60,000 home.

Monthly cost of $60,000 house with 10 percent downpayment assuming 25 percent of income for principal and interest:

EXHIBIT.—INTEREST RATES AND AFFORDABILITY

	Monthly payment	Annual qualifying income	Number of families qualifying [1]
Interest rate (percent):			
16	$726	$34,848	9,303,000
15	683	32,784	11,637,000
14	640	30,720	13,791,000
13	597	28,656	16,305,000
12	555	26,640	18,585,000
10	474	22,752	24,229,000

[1] Source: U.S. Bureau of Census, "Current Population Reports," series P-60.

cers are Leon T. Kendall (Chairman of the Board of Mortgage Guaranty Insurance Corporation), Milwaukee, Wisconsin, President; William A. Simpson (President of Republic Mortgage Insurance Company), Winston-Salem, North Carolina, Vice President; Claude E. Pope (President of American Mortgage Insurance Company), Raleigh, North Carolina, Treasurer; Henry D. Felton (President of Commercial Credit Mortgage Insurance Company), Baltimore, Maryland, Secretary; and John C. Williamson, Washington, D.C., Executive Vice President.

Looking ahead, we foresee a level of housing activity between 1.3 and 1.4 million starts in 1983. This is predicated on a continuation of the decline in home mortgage rates. Any reversal of the current trend will abort a goodly amount of this potential volume.

I expect accommodative monetary policy, modest economic growth and lower levels of inflation. These forces should serve to bring both long-term and short-term interest rates down further. A consensus forecast projects short-term rates in the 7 percent to 8 percent range, with the prime lending rate between 9 percent to 11 percent, and long-term governments around the 10-percent level. This scenario should make long-term mortgage funds available at between 12 percent to 13 percent through the year. Having said that, I must note there are a number in our industry who fear we may be planting the seeds of another inflationary spiral through massive federal deficits. Their positive outlook regarding 1983 and 1984 would sour if excesses in government spending were to occur. It is essential that this subcommittee recognize that the housing market is recovering without government stimulus for the first time in recent memory. No special housing assistance programs have been adopted. The gains made and expected in housing can continue only if public policy takes the necessary steps to maintain lower levels of inflation and lower levels of long-term interest rates. Home ownership cannot be financed without the availability of mortgage funds at affordable rates.

There is one other special factor at work in mortgage finance today which should be brought to the committee's attention. In 1982, new mortgage originations totalled approximately $90 billion. Housing starts of 1.3 to 1.4 million units and equivalent levels of existing home sales will increase mortgage originations by about one-third to $120 billion. (In 1978, mortgage originations totalled $185 billion). The demand for mortgage money will be well in excess of $120 billion because of refinancing of existing mortgages. Informed observers indicate that one-third or more of the mortgage loans being closed today represent refinancing of existing loans. For example, homebuyers forced to take short-term, two or three year balloon notes, sellers who took back paper and carried it themselves, individuals with escalator or adjustable rate contracts with short maturities, all are under pressure to convert their temporary financing to long-term contracts. This phenomenon is well-known in corporate finance. At the end of a credit crunch corporations will come to long-term capital markets and seek new debt to pay off short-term bank loans and other high-rate financing. This never happened in the mortgage field.

Today refinancing is a market force. It accounts for a major portion of the upswing in FHA lending and I am sure in our privately insured mortgages as well. Our new application volume at MGIC was up over 85 percent in the fourth quarter and in early 1983 has been running 100 percent above year-ago levels. As rates come down, such home refinancing requests will increase. On the other side of the equation, this demand will keep mortgage rates higher than they might otherwise be. Thus, I believe the spread between mortgage rates and Treasury and "AAA" corporate rates will widen and that home mortgage rates will be sticky until the loans to be refinanced work themselves through the market.

My conclusion is this: Unless we get a sharp reduction in the general level of interest rates in this nation, the housing recovery will be gradual, rather than exuberant. Housing's fortunes will be tied more closely than ever to the level of interest rates in national capital markets.

Any assessment of 1982–1983 by a representative of the private mortgage insurance industry would be incomplete without a comment on delinquencies and foreclosures. Within our firms we term 1982 "The Year of the Claim." Our insurance policies have been called on by lenders to a greater degree during the past twelve months than any year in our history. The systems put in place at the inception of the industry, embodying special contingency reserves to protect policyholders against periods of severe unemployment and investment policies which seek to be counter-cyclical, have worked admirably. Every member of the industry is paying more claims than ever before.

Delinquency and foreclosure rates, tied as they are to the levels of unemployment and financial distress on the part of borrowers, continued to rise through the fourth quarter of 1982. Although the rate of increase has slowed, one cannot be sure we have yet seen a peak in either measure of this cycle. Admittedly, foreclosures are a lagging factor in any recovery. And in this recession, the fact that interest rates remained high despite high unemployment, confronted individuals who did get in trouble with a much more difficult task in getting out of their problems. In addition, lenders developed a host of new mortgage forms under the guise of creative financ-

ing to overcome the stress conditions of the past two years. Some of these new mortgage forms are still untested as to risk.

Risk management executives of our member companies are hard at work seeking equitable and intelligent solutions to the foreclosure problem. They have as their goal keeping as many households as possible, especially the unemployed and underemployed, with good payment records in their homes.

ACTIONS FOR MARKET IMPROVEMENT

There are a number of public policy steps that can be taken to sustain the current recovery in housing and to enhance the capacity of the private sector to support the demand of Americans for shelter in the balance of the 1980's. Our first two recommendations are short-term and address the current stressful conditions in the real estate field.

(1) Increase FHA capacity.—In order to meet current insuring demand without budget or personnel increases we recommend the agency be permitted to purchase reinsurance and underwriting services, commercially, from private companies.

The recent decline in interest rates has resulted in an extraordinary increase in applications at FHA offices. Volume has risen from the 500,000 annual rate to 1.4 million. Backlogs are large and growing. The early and efficient processing of these applications could do a great deal to put construction and real estate people back to work. In addition, the agency is coming very close to its legislative authority to provide further insurance coverage. We propose that the FHA be authorized to enter into a reinsurance agreement with the private mortgage insurance companies of this nation. FHA approved mortgages would then have at their disposal the 260 MIC regional underwriting offices serving all fifty states, as well as the financial strength and claims processing ability of our industry. In outline form such an FHA/MIC shared risk program might work as follows:

(a) Each MIC under a reinsurance treaty with FHA would provide underwriting services on a delegated basis, reinsure the top 25 percent of each individual risk, and perform all necessary claims services on FHA loans.

(b) Lenders would initiate applications for FHA mortgage insurance as they do today and submit same to any qualified MIC with whom it has a master policy.

(c) If contracts include a down payment of 5 percent or more, the MIC would process the application according to its underwriting procedures and issue a policy to FHA insuring the top 25 percent of the mortgage. The terms of the policy and premiums charged FHA would be those presently employed for conventional loans.

(d) If down payments were less than 5 percent and therefore legally ineligible for private insurance, the application would be forwarded to FHA by the MIC.

(e) As a delegated reinsurer or processor, the MIC could endorse the contract for full FHA insurance, thereby providing in one step the traditional FHA coverage. The MIC would also handle delinquencies, foreclosures and claims reporting its actions and settling the claim with FHA.

(f) FHA would continue to charge lenders its traditional premium and pay all claims on a full and timely basis. The MIC would receive reinsurance premiums on a routine basis from FHA.

We believe such FHA mortgages would be eligible for pooling in GNMA (Ginnie Mae) issues as well as those of FNMA (Fannie Mae) and FHLMC (Freddie Mac). The program would solve the operational problems facing the agency without expanding program personnel or budget. Private insurance on a portion of the FHA loan would expand FHA capacity and begin to reduce the government liability from the guarantees. Furthermore, the program would be at a lenders option and if the current surge of volume were to subside the reinsurance agreement with our industry could be structured to allow the FHA to withdraw. The proposal is aimed to improve FHA program efficiencies.

(2) Prevent unnecessary foreclosures.—Programs should be developed immediately to prevent the loss of homes by under-employed and unemployed workers with good prospects of re-employment as the economy improves. Risk management professionals in our indutry are convinced that deserving home owners who are temporarily unemployed or under-employed can maintain their homes and will fight to protect them if given a chance. Working with 230 seriously delinquent borrowers in Cleveland, MGIC found that counseling and refinancing of their loans resulted in a 75 percent success rate in reinstating delinquent mortgages without foreclosures. Terms were developed that both the lender and borrower could live with.

Many other companies within the industry have also been attempting to address the problems of delinquent borrowers. In most cases the personalized or individual

case approach has delivered the most success. However, given the magnitude of the problems in some areas a more uniform effort may appear warranted.

There are a number of bills before this Congress designed to attack this problem and relieve the personal distress as well as the distress created on local real estate markets. Given pressures on deficits and budgets, we view those proposals that avoid outright federal cash payments as likely to be the more efficient and practical way to do the job. They key to any effort will be reliance upon the private sector especially the enthusiastic participation by lenders. It will also require that lenders remain the front line of contact with delinquent borrowers and their important relationships with borrowers cannot be over looked in program development. The various responsibilities of all parties should be clear especially with regard to the counseling of borrowers and determining what borrowers are worthy to participate. We offer our experience as risk management professionals in developing practical definitions and any program.

Over the longer term, there are two additional areas of action that will provide market improvement.

(3) Tap new capital.—Strengthen the ties between local mortgage markets and capital markets by attracting new pools of capital to home mortgage investment. One major step in this direction would be to remove impediments in current securities regulations, tax laws and pension fund rules so that more non-traditional investors might become increasingly disposed to mortgage investments. We understand that the Administration is developing tax code proposals along with a series of other regulatory changes that would go far in steamlining the issuance of private mortgage securities. This effort, brought together under the acronym TIMs, for trust in investment in mortgages, could prove to be an immensely valuable tool to the housing marketplace and we urge Congressional support for it.

(4) Modern instrument research.—There is a need for authoritative research regarding the quality of mortgage credit. Lenders have for some time now been in the process of developing a panoply of modern mortgage instruments. However, not all mortgage forms are good. Only through careful design of instruments and analysis of the performance record over time and different economic cycles will we be able to ascertain their value to homeowners and investors.

As mortgage lenders tune the designs of the instruments to meet their perceived operating needs, all parties to the financing process must understand the risks involved. This research presents an important challenge. Government agencies, such as the Federal Home Loan Bank Board and HUD, as well as private groups, should undertake systematic and thorough investigations and modeling to analyze and evaluate the performance of borrowers under various mortgage instruments and simulated economic scenarios. The collection of data and generation of studies and reports on lenders performance and loss ratios with modern mortgage forms is crucial to an efficient system of mortgage finance during the balance of the 1980's. The difference between good performance and poor performance on a mortgage investment may be translated into as little as one or two more foreclosures per 100 contracts. MICA pledges to support such efforts wherever they are undertaken to the fullest of its abilities.

Summing up, the changes underway in the American economy, especially the commitment to deregulation among financial institutions, will have far-ranging effects on housing and the amount and type of funds available to finance the shelter needs of the next generation of American households. If this nation hopes to provide adequate shelter through private markets, strong steps must be taken now to close the gap between supply and demand by attracting new pools of capital to local home loans. Builder/developers, lenders, investment bankers and mortgage insurers are ready to accept the task of originating new security instruments. Congress and appropriate federal agencies would do well to encourage such development where it enhances funds availability.

Mortgage lenders, working with mortgage insurers and others in the marketplace, must help homebuyers meet the affordability challenge. The mortgage instrument must be modernized in ways which are fair to all parties concerned. The private enterprise system, which has made Americans the best-housed people in the world, and with the appropriate encouragement from the public sector, can meet and master the dual challenges of availability and affordability of mortgage funds in the 1980's.

[Appendix]

CRITICAL REVIEW OF THE ROLE OF HOUSING, 1972-1982

The ten years 1972-1982 will go into the annals of American economic history as a unique decade. Record levels of Government spending, record deficits at Federal, state and local levels, spiraling energy and food costs, and mounting medical costs all combined to produce troublesome results in any number of markets. The double-digit inflation and double-digit interest rates created a willingness, even a desire, on the part of Americans to be debtors rather than savers. No market was more affected than the housing market—homebuyers, home owners, mortgage lenders, real-estate agents, builders and developers.

The record shows we built more new houses; we sold and bought more existing properties; we increased the level of home ownership. It also shows that we charged progressively higher interest rates, invented unique new forms of mortgages, and ultimately polluted the quality of mortgage credit in our quest to cope with surging house prices and interest rates.

INFLATION ALTERS USES OF A HOME

The demon inflation affected attitudes and changed behavior patterns. A few people said: Be careful, inflation can destroy you. Many, many more decided they could beat the system and learn to live with inflation. Some even determined to use inflation to speculate for personal financial gain. Being a pragmatic people, as the '70s moved along we acquired new attitudes toward the uses we could make of a home and our individual decisions reflected it.

In the early '70s, the New York Stock Exchange commissioned a study by a prominent opinion research corporation inquiring into the attitudes of people toward investments. Respondents gave first place to owning a vacation, ski, or seashore home. In second place was a home of one's own. Common stock, as I recall, came in fifth or sixth place behind savings accounts. (The Exchange elected not to publish the report). The report showed consumers were not ahead of their investment advisors. Not only was a house the number one investment—it was also regarded as a hedge against inflation and the average man's tax shelter. It could do even more. A house could be the foundation of a retirement nest egg or inheritance, could put a child through college, could even finance a new boat or a trip to the Orient. And while it was doing all this it provided an upgrading in the quality of life and lifestyle.

The sagest counsel seemed to be: Get into this game early and pay whatever entry price is necessary. Of course, to liquify his investment the homeowner had to use a second or third mortgage or other forms of junior financing. Furthermore, why not buy two or three houses, for then you could double or triple your prospects to share in all this largess? There were money lenders who would be pleased to accommodate you. Some even proposed a shared-equity mortgage to get into the act.

In no place did such attitudes take hold with stronger conviction than in California. Television news segments showing people queueing up to enter an auction for the right to buy a home seemed to say it all for most people. And the statistics say Californians were not wrong for most of the decade. Prices of homes, which trended moderately upward since World War II, took off between 1974 and 1980 at an incredible rate, unprecedented in our history. The rate of increase in house prices not only rose each year, but rose in an accelerating fashion:

	Increase in house prices (percent)	CPI less housing
Between:		
1974 and 1975	+10.1	+8.8
1975 and 1976	+8.9	+5.8
1976 and 1977	+12.2	+6.2
1977 and 1978	+13.4	+7.7
1978 and 1979	+13.4	+11.1
1979 and 1980	+10.4	+13.5

Unmortgaged equity in American housing stock reached an estimated $3.1 trillion. In addition, the gains exceeded the increase in the consumer price index, excluding housing.

The double-digit increases in house prices were aided by forces holding down new housing supply. Restrictions on use of land for environmental reasons, the desire of the "haves" to prevent further development in their communities, the use of building and other codes to constrain growth, usury laws and other financial constraints all restricted supply.

SPECULATION IN HOUSING

Add to this or ignite it with the psychological desire of Americans to double their money in speculative ventures and you put in place the ingredients for a speculative euphoria that in the past has carried values in other markets to new and ultimately unsustainable heights. Charles Mackay, in his Memoirs of Extraordinary Popular Delusions and the Madness of Crowds, points out:

"In reading the history of nations, we find that, like individuals, they have their whims and their peculiarities; their seasons of excitement and recklessness, when they care not what they do. We find that whole communities suddenly fix their minds upon one object, and go mad in its pursuit; that millions of people become simultaneously impressed with one delusion, and run after it."

Early speculative bubbles include the Tulip Mania of the 17th Century, the South Sea Bubble, and the Florida land boom of 1924. Two more recent phenomena are the hot new-issue boom in Wall Street in the middle '60s and the euphoria for mutual-fund investment and their money managers of the late '60s. Historians, I think, will put the house-price boom of the middle and late '70s in the same category of human events.

As we moved to 1981 and 1982, homebuilding activity fell to the lowest levels since 1946. Today delinquencies are at a post-war high and forclosures are rising rapidly. House-price inflation has subsided; new home prices in the first quarter of 1982 actually declined for the first time in eleven years. Obviously an adjustment is underway; I submit that that adjustment represents not only the effects of extraordinarily high interest rates and unemployment, but also the demise of a euphoria which permeated the middle and late '70s.

1981–1982 LESSONS

What lessons can we learn from the 1981–1982 downturn?

We will learn that the 1974–1980 era was unique—and an aberration. Housing and the ownership of a home were never meant for speculation. In fact, houses are not very good vehicles for it. Houses cannot deliver with any degree of certainty the equity build-up necessary to support family fortunes, college educations and the better things of life.

We will learn that how much down and how much per month are no longer the first and only questions to be asked in purchasing a home. Real values represented by location, quality of schools, proximity to job markets and similar features are more important to resale prospects.

We will also learn that people can live out their mistakes or "top-of-market" purchases—something that is not always true for other types of assets.

We are learning that the mortgage finance systems of the '30s and the kind of mortgages which came from that era will not work in the '80s.

Buyers also learned, however, that not all types of modern mortgages are good for them; lenders learned that some of the mortgages they designated, based on the premise that the contracts would solve their particular operational problems, might not be accepted by home owners.

We are learning that the margins or tolerances for bad lending in the mortgage field are all too narrow.

Second mortgages depending on the prospect of continued inflation turn out to be losers, not only for investors who purchase second deeds of trust and mortgage insurers who take the top risk, but also for home owners who create them.

In addition, we will probably learn that in times of euphoria the quality of credit will deteriorate as the best lenders and the best of appraisers and realtors give in to pressures and, as they say, go with the flow.

Bankers learned during these volatile years that lending long and borrowing short can be very dangerous to financial health.

But we learned some very positive things, too.

We learned that Americans can pay a good deal more for housing than we ever thought—and that they will do it.

We learned there is ample room for modern mortgage instruments that are carefully and thoughtfully designed.

We learned that mortgages in securities form can provide new savings and investment funds for housing without Government subsidies.

CHANGING ROLE OF GOVERNMENT

During the late '70s and early '80s, Government systematically began to withdraw its support for housing. The 1981-82 recession was the first in several decades where no special housing-assistance program emanated from Washington to get the economy moving again. Congress phased out Regulation Q, which limited rate competition for savings funds at thrift institutions and banks, and the Administration sought to limit the subsidy on FHA and GNMA mortgage insurance programs. The effort to restrict or channel mortgage revenue-bond funds to moderate income groups might well be considered another step in the same direction. Private enterprise can take up the slack. Home owners can pay interest rates higher than those charged the best American corporations and still afford a home of their own. They have done it before—in the '50s and early '60s. Before Regulation Q, mortgage money cost 2 percent more than corporate funds—6 to 7 percent while AAA corporate bonds yielded 4 and 5 percent.

On the local scene, municipal governments are likely to encourage additional new-home construction to increase the size of their tax base. During the '70s, growing pools of revenue-sharing funds plus the attitudes of the "haves" in the community combined to restrict outsiders restrained development. Today, one way to solve the problem of revenue loss is to increase ratables, and a way to do that is to encourage more intensive utilization of the land area under one's charge. School enrollments are falling and teachers will be a powerful lobbying force to attract new houses and young families to enter their districts. Just as local forces restricted supply in the '70s, they may increase supply in the '80s.

OUTLOOK FOR THE 1980'S

Given these forces, what do we do now to house the next generation of Americans? Assuming lower levels of inflation—5 percent or less; Assuming no subsidy for housing by Government via uniquely low interest rates; Assuming savers will want a real rate of return on their money; and assuming land developers, builders, realtors and financiers will produce real values for which they will earn a profit—I see the '80s as a period when housing returns to a status similar to that which it occupied prior to the speculative '70s. We will go back to basics.

Owning a home of one's own will be an expense of living. A home will be something one purchases because it provides comfort, amenities, and the lifestyle one seeks and is willing to pay for. A home can retain and even rise in value—if purchased right and maintained properly. It can still rank high as a valued asset and can produce a long term capital gain. But it will no longer come in as number one among best speculative or short term investments. People will look for value prior to purchase, value in the form of sound construction, good location, desirable neighbors, superior schools, good local government. I see the skillful use of land sites, condominium units, manufactured homes, and energy-efficient structures as having special merit in meeting the challenge.

Who wins? Those who deliver value will win—developers, builders, realtors, and mortgage financiers—those who through their efforts and product create above-average benefits for that consumer.

Where will the money come from to house the next generation of Americans? From many sources.

During the '60s and early '70s in most parts of this country, more than seven out of ten dollars used to finance a mortgage came from people who lived within 25 miles of that house. The Savings and Loan associations and local banks did the job. They attracted money on a retail basis in $50, $100 and $1,000 deposits, assembled it and sold it wholesale in the form of $50,000 and $100,000 mortgages. Today, Americans are all saving differently, largely through pension funds and various forms of national money-market instruments. The challenge our local mortgage originators face is to learn how to buy money wholesale in $5 million and $10 million amounts, and distribute it retail, as $50,000 and $100,000 mortgages.

We are well on the way to making this happen. The Administration and Congress are pushing new laws and regulations which hold great promise. State retirement funds are buying mortgage securities, and local loan originators are finding ways to tap these new markets.

The CHAIRMAN. Thank you very much, Mr. Kendall. Mr. Shane?

STATEMENT OF LEONARD SHANE, CHAIRMAN, U.S. LEAGUE OF SAVINGS INSTITUTIONS

Mr. SHANE. Mr. Chairman, I really appreciate having the opportunity to be here. Recognizing the time constraints, I'm going to avoid duplicating anything that is in the written testimony which has been resented.

I was pleased to note this morning you already read my statement, so I will assume that that will be contained in the record.

The CHAIRMAN. Yes, it will.

Mr. SHANE. I would like to discuss several other items, however, in an attempt to touch upon some matters of perspective, if I may.

First, I would like to divide the question of the thrift industries—the savings and loans, as intermediaries operating in a financial environment—their condition and what they are doing and so forth, from the overall question of this hearing which is housing and home ownership.

That's not to say that savings and loans are not indivisibly intertwined with housing and homeownership. We are, but in connection with the first portion, I would like to take this opportunity again to commend the Garn-St Germain bill, what it did, the timing of it, the addressing of the issue in times of great crisis, the decisions that it has permitted to be made, the restructuring that it presages and all that it represented on a much greater scale, I think, than a great many people really understood.

And I think that while there are other portions or parts of the debate as it relates to housing, other portions of that bill as the bill of 1980, the deregulation bill, in which perhaps those that were charged with operating under ran a little faster, or perhaps in some tangents not exactly expected by Congress.

In all seriousness, we have had that discussion—I'm aware of your concerns—but I think we steered clear of that in today's discussion, because I think today is different.

Also, I hope that you don't misunderstand what I am about to say, but I want to put the U.S. League of Savings Institutions, for whom I speak today as chairman—I want to put it in perspective as it relates to this hearing.

For example, our trade association's members, the savings and loan associations of the United States, have originated I'm told more loans than all the rest of your witnesses' organizations put together—I do not mean to derogate them.

We have a relationship with each and every one of the witnesses that has been here of organizations today. That is worth mentioning quickly in passing. Obviously with HUD our members do originate FHA and VA loans, and of course we are involved in that.

The Honorable Richard Pratt is of course our regulator. We salute him for that. Mr. Maxwell heads an organization with whom our members do a great deal of business; we are suppliers of loans to Fannie May. Mr. Thygerson represents the Federal Home Mortgage Corporation, which is owned by the Federal home loan bank system, and of course with whom we do some business and sell mortgages.

Mr. Wooten represents an organization of whom we are very fond, because they provide us with bonds. We buy from them, we

really love them dearly. Mr. Kendall's organization insures the mortgages that we originate; Mr. Herbert Gray, I would point out, is the only other representative of a depository institution who is here today.

CAUTIONS TO BE EXPRESSED FOR THE FUTURE

And that perhaps leads me to my next point: He and I share a great many views, and I think the response to the direct question as to the condition of the housing market at this point: I think we have to say in all honesty that it is encouraging where it is now, the signs are trending upward, but there are cautions to be expressed for the future, and Mr. Gray expressed them extremely well.

We, who are in the depository institution business, who have a long-range relationship with both the investor and saver and the borrowers and the homeowner, have to recognize that today's quick fixes are not necessarily tomorrow's long-term solutions. I am distressed that some of the really significant areas that have to be addressed are not getting addressed today, although many of the people who appeared in the first panel are very quick to give us a lot of advice.

We are totally committed to this question of the potential deficit crunch. Every speaker has mentioned it. Our industry is absolutely totally wringing every possible alarm bell it knows how to ring.

The Treasury's deficit is capable of crowding out all kinds of credit from the marketplace, but more particularly, it is capable of crowding out the American dream, the aspiration for homeownership.

Mr. Chairman, what we describe as the voracious appetite of the Treasury really can only be satisfied with the very tightest of budgetary constraints. I know, speaking for the savings and loan industry and the others I've mentioned, we really have to face the consequences of a failure to control the credit markets, and the consequences of the social disaster, not just economic statistics—and I will refer to social problems as we go through today.

There's another phenomenon taking place that must get your attention, Mr. Chairman, and what it proves is that sometimes the best laid plans and the best economic projections are just not accurate enough, and sometimes the results are so great that they inundate you.

One of the objectives of the Garn-St Germain bill was to provide a vehicle for answering the money market mutual fund invasion on the credit markets. My personal view is that that should have been handled several years ago in a different way. The money market mutual funds which are a cancer in our economy should have been brought under control then and brought into the system so we would not have to be responding to the short-maturity syndrome.

But we didn't do it that way. Instead we have responded with hopefully a method of competing with that. The Garn-St Germain bill mandated a method of competing, and our regulators responded and we—meaning the depository institutions—generally were given a deregulated, effective, 1-day maturity account to go out and compete with them.

I don't think anybody as yet has any understanding of the magnitude of what is already apparent. Mr. Chairman, we've got over $200 billion, that's a fifth of a trillion, that has already transferred into these new accounts since authorized a few weeks ago.

The financial institution I manage in California currently has 32 percent of its total savings portfolio in the two new accounts—the money market account, the super NOW account—and others have more.

Mr. Chairman, we are on the way to a great success which could presage a great disaster. This account was supposed to be a method of generating liquidity, but it is headed toward a third, a half or more of the total deposits winding up in 1-day maturity accounts. Remembering the subject of this hearing, to try to discuss long-term housing finance in the context of this warp in maturities, to attempt to determine any form of long-term credit availability in this country—we're now getting something entirely new as a phenomenon. We're getting an intermingling of what was traditionally the savings funds with what was traditionally the transaction funds.

Today you have savings accounts that are really checking accounts that are paying interest like certificates of deposit. It's no wonder that the Fed can't control any of the M's and we're going to have to have some new M that would be an M&M that won't melt.

So we're going to have to have something, Mr. Chairman, to begin to measure this, but I don't think the word has gotten to our leadership perhaps here in Washington of how successful this new account is.

I read it as an alarm bell for housing, not as an alarm bell for the financial institutions. I guess in a way I'm sad to tell you it probably will be a very profitable thing for the banks and the savings and loans.

But you're not here discussing the profitability of banks and savings and loans; we're discussing homeownership. We now have in this country, and by next week it will be more, over $400 billion worth of deposits in 1-day maturity accounts, either in financial institutions or the residual funds of the money market mutual funds.

It's small wonder that the Treasury last week had a little trouble selling 30-year bonds. You're going to have more trouble, Mr. Chairman, as you address any form of long-term capital until you address this question.

The only other thing I would attempt to say here is that homeownership, which we take for granted is the American dream, really is undergoing an attack, an assault, a threat. I don't know that I want to go into something that was said earlier today, which is a decision on the part of some to steer capital away. A Member of the Senate said that, I would tend to concur, but I don't think that's the issue today.

Mr. Chairman, in 1970 in this country we had 63 percent of our families as homeowners. By 1980 that rose to 65½ percent. It has now dropped to 62 percent. In less than 2 years we have wiped out the entire growth of homeownership, percentagewise, in this country that took place in the previous decade.

We are making homeownership increasingly more difficult by our financial structuring. Yes, there are more dollars available today because there's great liquidity; yes, there's a pent-up demand on the part of those who have marginal ability to qualify; yes, we have all of the short-fix answers, and everybody is very happy in the short term to see us doubling from a very low level.

Mr. Chairman, I am urging in our testimony on behalf of our industry that we raise our time perspectives, that we look at the longer range as we are coming out of the present crunch. There is no simple, single solution.

AREAS TO EXAMINE FOR SOLUTIONS

In the past we have looked for quick fixes and simple solutions. There are three areas that we must examine, Mr. Chairman. One obviously, the Federal budget. This precedes everything else.

Second, a close examination of the policies that started in 1980 which warped the Nation's entire investment maturity fabric. We are now dealing in short-term credit only at the expense of long-term credit.

And finally, new sources of capital for homeownership, some of them mentioned today, in terms of the secondary market. I would point out to you, Mr. Chairman, that in terms—and I do not mean to derogate the one we own which is Freddie Mac—but we have one savings and loan in the United States that has a lending volume equal to Freddie Mac's whole annual product.

So we have to keep the secondary market in its proper perspective.

Mr. Chairman, there's much more to be said, and I'm not going to say it now because I've gone on too long, but I hope that you aggressively address the needs of homeownership and other forms of long-term credit, or else we're going to have a set of unanticipated circumstances that we're going to have to cope with in a very strange way.

The CHAIRMAN. Thank you, Mr. Shane. I can't resist retelling the story that happened last year. We know each other well enough, I know you won't take offense, but Chairman Volcker testified before the committee and I asked him to summarize his testimony, and it went on at quite great length. When he came on back later in the year I asked him if he would please not summarize his testimony but read it in full because it would take less time. [Laughter.]

So we are happy to include your whole statement in the record.

[The complete statement follows:]

TESTIMONY OF LEONARD SHANE, CHAIRMAN, U.S. LEAGUE OF SAVINGS INSTITUTIONS

Thank you, Mr. Chairman, and members of this Committee. My name is Leonard Shane, and I am Chairman and President of Mercury Savings Association of Huntington Beach, California. I appear before you today in my capacity as Chairman of the U.S. League of Savings Institutions [1], the principal trade association of the thrift industry—this nation's primary residential mortgage lenders.

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[1] The U.S. League of Savings Institutions, formerly the U.S. League of Savings Associations, has a membership of 3,800 companies representing over 99 percent of the assets of the $700 billion savings and loan business. League membership includes all types of associations—Federal and state-chartered, stock and mutual. Many prominent savings banks belong as associate mem-

Continued

We welcome this opportunity today to offer our view of the current state of—as well as the prospects for—home ownership in the United States. We also welcome this occasion to provide the thrift industry's insights into how our outstanding housing delivery system might be preserved—specifically from the financing side—so that we might satisfy the tremendous housing demand that is embodied in the post-war "baby boom" generation.

It is our fervent hope that from the groundwork laid here today will emerge a carefully-considered, long-range national policy commitment that home ownership should be within the reach of all who aspire to it. And, while recognizing that it is the private sector which ultimately must deliver, government must not inhibit the delivery process which has made us the best-housed nation in the world.

It is our sincere belief that much remains to be done by government by way of removing obstacles which inhibit the opportunity for homeownership.

A REVOLUTION IN THE MARKETPLACE FOR SAVINGS

Before exploring housing demand for the short- and long-term, and current conditions in housing and home finance, we must recognize the significant—indeed, revolutionary—changes which have occurred recently in the marketplace for savings. The depository configuration of out nation's insured financial institutions—commercial and savings banks, savings and loans and credit unions—is in the midst of a tremendous, and, as yet, unmeasurable change.

Savings accounts have traditionally been a depository service distinct from transaction (demand) accounts. They were distinguished in the public's perception and they were distinguished in the uses to which deposits were put by financial intermediaries.

With the arrival of the Money Market Deposit Account (MMDA), mandated by Section 327 of the Garn-St Germain Act (Public Law 97-320), and the companion "Super NOW" account authorized by the Depository Institutions Deregulation Committee in December, the savings/transaction account distinction has been commingled.

Since December 14, when the MMDA was introduced, these accounts have demonstrated tremendous popularity with the customers of depository institutions. Perhaps $200 billion have "shifted"—internally, from lower-interest savings or expiring certificates, or from competing depositories—or have been attracted from non-depository sources, such as the money market mutual funds. In just two short months, the balances in these accounts at banks and thrift institutions already have grown to exceed the total invested in the money market funds.

At my own institution, Mercury Savings, 32 percent of our total deposits are in MMDAs or Super NOWs. It is not unreasonable to expect that for the industry as a whole, one-third or even one-half of our deposit base will be comprised of these accounts by the end of the year.

Obviously these accounts have replenished the deposit flows, the "liquidity," of banks and S&Ls. They have been a satisfying, short-range "feast" (introduced, as they were in a declining interest-rate period) for our thrift institutions "starved" for deposits. By rechanneling funds to home-town depositories, they are providing at least a partial answer to the "disinvestment" created by the money market fund phenomena.

But the inherent liquidity of what is quickly becoming the "core" or "dominant" form of savings also brings with it another attribute: a drastic foreshortening of the maturity of the deposit base. (Indeed, some of my colleagues refer to the MMDA as the "Money Market Daily Account.")

We must understand, too, that these new products are entering the deposit marketplace at premium rates. The emphasis they place on high rates and short maturity led Henry Kaufman of Salomon Brothers to observe recently that this new configuration of accounts has resulted in higher interest rates for the markets generally "at a time when the prerequisite for economic revival was, and is, lower rates."[2]

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bers. The principal officers are: Leonard Shane, Chairman, Huntington Beach, California; Paul Prior, Vice-Chairman, New Castle, Indiana; William O'Connell, President, Chicago, Illinois; Stuart Davis, Legislative Chairman, Beverly Hills, California; Arthur Edgeworth, Director-Washington Operations; Phil Gasteyer, Legislative Counsel; James Freeman, Senior Legislative Representative. League headquarters are at 111 East Wacker Drive, Chicago, IL 60601. The Washington Office is located at 1709 New York Avenue, N.W., Washington, D.C. 20006. Telephone: (202) 637-8900.

[2] Address to New York Bankers Association, January 27, 1983.

THE THREAT OF FEDERAL DEFICITS TO HOMEOWNERSHIP

These concerns take on even more importance in the context of the looming Federal deficits and the demands they place on the funds available from private, household savings.

Estimates distributed at the time of the fiscal year 1984 Federal Budget documents say that the equivalent of 94 percent of net private savings might be absorbed by government borrowing in fiscal 1984, and 81 percent in fiscal 1985. The focus of Wall Street on the pending debt-financing load is all too apparent in the distressing rebound in market rates over the past six weeks. It was apparent, too, in the great difficulty encountered last week when the U.S. Treasury attempted to auction a three-year note and a 30-year bond. Those auction results strongly suggest that today's marketplace wants shorter—not longer—maturities, even at the double-digit rates offered. This appetite for shorter maturities was whetted, in my opinion, by, first, the money market mutual funds, and now, the immensely-popular MMDA and Super NOW accounts.

Without significant Congressional and Administration action to minimize government borrowing, this "deficit scare" mentality will keep rates too high to sustain a meaningful housing recovery. Government always stands first in line at the credit window, with business but a step behind; homebuyers have access to what is left.

Both business and housing need long-term credit for a lasting national economic health. But it is important to remember an essential difference between the sources of credit for business and commerce and those which supply housing needs. Home borrowers depend upon an income stream over many years to repay their mortgage debt; businessmen can pass along the debt burden in the price of the goods or services they provide. In the past, household savings have provided the foundation for long-term homeownership credit; with the revolution in the savings marketplace, the availability of that credit source is brought into question.

HOUSING DEMAND AND AVAILABLE SAVINGS

During the decade of the 1980s, 42 million Americans will reach the age of 30—10 million more than reached that age during the 1970s. These are extraordinary demographics, and their impact in terms of demand for goods and services and upon the labor market has been widely publicized. What has escaped the attention of many public policy makers, however, is the demographic impact on potential savings available for investment.

Consumer behavior tends to follow a life cycle. The prime borrowing, or dissaving, phase of this life cycle extends approximately from age 25 to age 45. These are the years when households are being formed, careers launched, and children reared; virtually all of these needs are met by heavy reliance on credit.

Children have left the nest, generally about the time parents have reached age 45. The years between 45 and 65 can be characterized as "high flow" saving years. Both the willingness and the ability to save is strong, since incomes are high relative to the demands placed upon them.

Beyond age 65, when retirement typically occurs, households may continue to save a high proportion of their income, but because income tends to decline with retirement, the savings flow of retirees declines.

Taken in the context of the demographics of the 1980s, the life cycle of saving is acutely relevant to the issue of the availability of capital for the economy as a whole and for housing in particular; the 1980s will see a smaller number of Americans in the prime saving age of the life cycle relative to those in the prime borrowing phase than at any time in the last half of the 20th Century.

According to U.S. Census Bureau projections (Series II), there were only 1.06 prime savers for every prime borrower in 1982. In 1987, when the ratio reaches its low point, there will be only 0.89 prime savers for every prime borrower, the lowest value for this ratio in the entire last half cf the 20th Century. By 1999, the ratio will be higher, at 1.16 prime savers for every prime borrower, but it still will not have returned to its 1971 peak value of 1.31.

The funds supplied by personal saving have exceeded the requirements of housing investment in all but 9 of the 22 years between 1960 and 1981. Cumulatively, personal saving in excess of residential investment has been equal to 42 percent of the cumulative government deficits over this period.

In a market environment, declining personal saving rates in the face of large government deficits bear ominous tidings for homeownership.

Two important implications emerge. First, if government deficits are not quickly brought down to reasonable levels, there is likely to be an acute shortage of funds available for housing. Second, the level of interest rates likely to appear under such

circumstances would be especially prohibitive for first-time home buyers; the percentage of homeowning households would therefore decline.

Estimates of potential housing demand in the decade of the 1980s vary widely, and past patterns of household formation may not be reliable indicators for projecting household formation rates for the maturing "baby boom" generation. There are additional complications that arise from regional migration by choice and by shifts in the regional distribution of employment.

It would nevertheless seem unlikely to find housing demand satisfied in the decade of the 1980s at average annual production levels below 1.75 million units. With the starts achieved the past three years, housing production is already behind by one full year's production for this decade. There is virtually no prospect that 1983 production will meet its quota.

HOME PRICES AND AFFORDABILITY

Given the domographics of the 1980s, the heart of the homeownership market must be defined in terms of potential first-time buyers and empty-nesters trading down or exchanging homeownership for rental.

Among first-time buyers, a significant affordability gap can be expected to exist for some time, even if mortgage rates were to fall to the 11 percent range. Home prices, the legacy of inflation in the late 1970s and the product of excessive regulation at the local level, are the primary culprit.

First-time home buyers made up 36.0 percent of the market in 1977, when median home prices were $48,800 and mortgage rates stood at 8.8 percent. By 1979, the ranks of first-time buyers had been cut more than in half—to 17.8 percent—as median home prices soared to $62,900 and mortgage rates rose to 10.8 percent. The "affordability gap," defined as the difference between the actual median home price and the home price at the prevailing mortgage rate that would satisfy the 25 percent of income rule for the median income family whose household head was between the ages of 25 and 34, was a scarcely noticeable $2,400 in 1977. By 1979, the affordability gap had widened to $15,000.

By 1984, if median home prices remain constant at their 1982 level and mortgage rates fall to 11.0 percent, the affordability gap will be $14,000, almost as much as in 1979.

The affordability gap for first-time buyers means insufficient effective demand for housing. The percentage of households who are homeowners has, in fact, declined. In 1940, 43.6 percent of American families were homeowners; by 1960, that had risen to 61.9 percent; the savings and loan business played the major financing role in that achievement. Progress slowed over the next two decades, with homeownership rising only to 62.9 percent by 1970 and to 65.4 percent in 1980. Homeownership has, however, suffered during the past two years. In 1982, homeownership is estimated actually to have fallen to 63 percent. In other words, in two short years, the gains of the entire decade of the 1970s were erased.

Mr. Chairman, in my opinion, the downturn in homeownership is a very disturbing trend. Our nation's commitment to homeownership has traditionally gone far beyond economic gain to families and businesses. The stabilizing influence of homeownership is part of the very fabric of our free society.

CURRENT MARKET CONDITIONS

Housing had its last solid year in 1978, when new housing starts reached 2.0 million units. Then the decline began, with starts falling off 300,000 units to a total 1.7 million in 1979, and not bottoming out until the fourth quarter of 1981, when the seasonally adjusted annual rate sank to 865,000 units. The picture improved somewhat in 1982 as new housing starts reached a seasonally adjusted annual rate of 1.250 million.

The increase in building permits issued, which numbered 1.218 million in fourth quarter 1982, is also a hopeful sign for recovery.

On the other hand, sales of existing homes have not yet shown significant improvement. At seasonally adjusted annual rates, 2.1 million existing single family homes were sold in the fourth quarter of 1982, up only 8 percent from fourth quarter 1981. For the year as a whole, sales declined from the 1981 level of 2.352 million to a ten-year low of 1.947 million.

Mortgage lending through savings and loan associations rose substantially during fourth quarter 1982, reaching $17.6 billion as compared with $10.0 billion in fourth quarter 1981.

These signs are positive and support the growing belief that a beachhead has been established in the battle for economic recovery. Of course, pent-up demand accounts for a significant portion of these figures.

The conditions that have proved conducive to the improvement in the housing sector—lower mortgage rates and stable home prices—will hopefully continue. (As mentioned earlier, the recent backup in rates threatens this progress.) Conceivably, the second half of 1983 could permit the construction of roughly 1.4 million new housing units and approximately 3.0 million sales of existing single family homes. At current average prices of new and existing homes ($86,000 for new and $80,000 for existing homes) and assuming a "normal" amount of "creative" financing (25 percent of total requirements) approximately $155 billion of new home mortgage financing would be required to finance such production and sales levels in 1983.

With the estimated Federal deficit of $200 billion absorbing almost all of private household savings—the traditional source of residential mortgage credit—it is by no means certain that the mortgage markets will be able to claim the volume of financing required to validate a forecast of 1.4 million housing starts and 3.0 million resales.

Without significant action on the Federal deficits, the promise that housing now holds may well be snuffed out before 1983 comes to a close.

THRIFT DIVERSIFICATION AND A SUSTAINABLE HOUSING RECOVERY

Another important factor which can contribute to a sustained recovery is the asset diversification and capital assistance prospect for the thrift industry made possible by the Garn-St Germain Act of 1982 (Public Law 97-320).

Asset restructuring's importance to our institutions and to housing in America was perceived clearly in this Committee's report on the Garn-St Germain Act, which said:

"The need to restructure the thrift industry has long been recognized in the financial community and in Congress. It appears clear that defective structuring is a primary cause of the current economic vulnerability of thrifts. The high and volatile interest rates of recent years have illustrated starkly the inherent dangers of borrowing short and lending long at fixed rates. At the same time, competition for deposits has become increasingly fierce and expensive, due in large part to the rapid and enormous expansion of money market mutual funds. The potential benefits to thrifts that can be gained by authorizing the powers contained in Title III are illustrated by the experience of state-chartered savings and loan associations in Texas, which have powers in the areas of commercial and consumer lending similar to those that bill would provide to Federal associations. . . . (A)dditional asset powers provide a valuable means for thrifts to diversify their portfolios, create a better match between the maturities of assets and liabilities, reduce interest rate risk and, most importantly . . . (remain) firmly committed to housing despite the opportunities for alternative investments."

We firmly believe that the broader and more flexible asset powers will enhance our ability to serve homeownership in the future. In the wake of Garn-St Germain, there are further improvements in the laws governing savings institutions which need to be made. Some are in the direct jurisdiction of your distinguished Committee; others are not.

For example, the tax laws continue to discourage asset diversification. Realizing this is not within your province, I would point out that, while the investment powers of Federally-chartered savings banks and Federally-chartered savings and loan institutions are virtually indistinguishable following Garn-St Germain, these comparable institutions still have different qualifying tests for use of the loan loss reserves in the Internal Revenue Code. Your support in remedying this inconsistency would be most appreciated.

The 3 percent-of-assets limit on our service corporation investment puts Federally-chartered thrifts at a decided disadvantage to their state-chartered counterparts in many jurisdictions. At a minimum, the U.S. League requests an increase to 5 percent. (As you know, a 5 percent-of-assets limit was authorized for service corporations of national banks under Title VII of Garn-St Germain.) We vigorously oppose any renewed efforts to narrow by statute the range of activities available under the service corporation investment authority.

Similarly, we continue to oppose the potential barrier to unitary S&L holding company activities contained in Section 335 of the Garn-St Germain Act. In addition, we find the "anti-tying" language of Section 331 duplicative of pre-existing antitrust law and FHLBB rules and therefore superfluous; we repeat our request for

some regulatory discretion in that section—as found in the banking laws from which the language was taken.

As discussed at considerable length earlier in this statement, the far-reaching implications of the corresponding liability restructuring begun by Section 327 of Garn-St Germain are only dimly understood. However, it is already apparent that the Money Market Deposit Account and its cousin, the Super NOW account, are revolutionizing our core deposit base. These commingled savings/transaction deposits—high-rate, short-term, and extremely liquid—are certainly a new challenge to thrift institution management intent on continuing to serve the housing finance needs of our nation. Certainly, if the "deficit scare" provokes a new round of spiralling interest rates, their utility as a source of homeownership credit is open to question.

Thus, it is also important to encourage stable and systematic deposits. One such account category is presently available—Individual Retirement and Keogh Accounts. (Admittedly, these retirement accounts cannot attract systematic savings in sufficient volume to stabilize all of our home mortgage credit base.) We believe that improvements in these accounts—permission for excess, non-deductible contributions, for example—could expand their appeal. We were pleased to hear the President's call for an Education Savings Account, which, if properly structured, would encourage longer-term deposits suitable for investment in housing credit. Other contributors to stability and deposit growth would be a tax-deferred, annuity-type account; higher FSLIC and FDIC insurance of IRA and Keogh Accounts (as contained in S. 1720 last year); and, as was approved by this Committee during the 96th Congress, 100 percent insurance coverage of public funds—to attract state and local governmental unit deposits to our institutions.

SECONDARY MARKET AGENCIES' ROLE

The prudent manager will also look toward more sophisticated use of the secondary market programs. This means fuller utilization of the programs of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association.

These agencies have traditionally provided lenders with liquidity and helped to redistribute funds from areas of capital surplus to those of capital shortage. They have also pioneered in the use of standardized documentation and in the development of mortgage-backed securities attractive to non-traditional mortgage investors.

However, their direct support capacities are limited. Last year Fannie Mae acquired and held about $14 billion in residential loans while Freddie Mac acquired about $3 billion in a marketplace which requires perhaps $200 billion annually in permanent funds for residential credit if homeownership is to be served adequately.

There are statutory changes which could enable FNMA and the FHLMC to serve the mortgage marketplace more effectively. For example, removal of the statutory $108,300 loan purchase amount limit would provide greater efficiency to the FNMA and FHLMC operations, and permit them to serve more fully higher-cost housing areas such as my California market. Further, they should be positioned to provide outlets for all types of mortgage loans, with particular emphasis on adjustable mortgage loans which have gained market acceptance. We believe that the "borrow-short, lend-long" albatross with which our institutions must cope poses a like threat to these secondary market programs, particularly when loans are retained in portfolio.

Similar diversification should be encouraged in the Federal Housing Administration and Veterans Administration mortgage insurance and guaranty programs.

ALTERNATIVE HOUSING CREDIT SOURCES

There is no question in my mind that the overwhelming majority of our savings and loans institutions want to and intend to stay in the business they know and perform the best, and that is in mortgage lending. I cannot foresee that savings and loans will willingly surrender their leadership in providing home mortgage credit for the American people.

Having said that, and having said earlier that demographics and the revolutionized market for savings indicate that the task before us is enormous, it is realistic to examine alternative sources of credit available to the housing market now or in the near future.

We do not oppose legislative and regulatory efforts to encourage new sources of mortgage credit. We think housing is an altogether prudent and proper investment vehicle for pension funds, life insurance companies, commercial banks and their trust departments. (Indeed, mortgages have proven a far more secure investment than many other choices available to commercial lenders.) To date, however, their

participation has been far less than that of thrift institutions. As of September, 1982, while thrifts held 44 percent of outstanding home mortgage debt and commercial banks 16 percent, pension funds held only ½ of 1 percent.

S. 2918 of the 98th Congress would have granted a "class exemption" from certain provisions of ERISA and encouraged private pension plan investment in mortgages. We would support that legislation, too, although we did have some concerns about language inviting non-supervised mortgage origination and issuance of mortgage-backed securities.

Presently we are following with great interest the Administration's efforts to remove the legal barriers to the development of Trusts for Investment in Mortgages (TIMs), which encourage the formation of private conventional mortgage-backed securities. These could hold great appeal to individual and corporate participants in the securities markets.

SUMMARY AND CONCLUSION

Mr. Chairman, by scheduling these hearings today as your first inquiry in this 98th Congress, you and this distinguished Committee have demonstrated once more your willingness to assure that America is adequately housed.

It is my hope that these hearings will begin a national dialogue on the continuing priority for homeownership in our society.

In the last several recessions, housing has pointed the way toward national economic recovery. Housing starts, building permits, and mortgage lending data in recent months are headed in the right direction. Of course, to some extent, this performance represents pent-up demand.

The demographic data suggest a tremendous housing need in our society in the years immediately ahead. But the voracious appetite of the U.S. Treasury, driven by record Federal deficits, may consume great quantities of available savings resources, as well as drive up their price. A "deficit scare" could snuff out the nascient housing recovery.

The savings institution business has proudly served as the principal delivery system for mortgage credit over the past four decades; the magnitude of our commitment has far surpassed alternative sources for affordable long-term credit. Use of our depositories has worked to channel affordable long-term credit to homebuyers; many of us hope to continue to fulfill that role for which we are so well-suited. This is not to say that alternatives should not be explored; legal barriers which inhibit pension fund and trust department investment should be removed; secondary market agencies should be permitted to function more efficiently.

But, as depositories, our thrift institutions are concerned about a new, and revolutionary course, of savings behavior. A "warp" has developed in savings patterns—with consumers attracted to ever-shorter maturity commitments. The Money Market Deposit Account and the Super NOW account, so helpful in restoring liquidity for our home finance institutions, have also commingled beyond recognition the traditional distinctions between savings and transaction deposits. This, too, sounds an "alarm bell" for the future prospects for homeownership.

In the last Congress, this distinguished Committee rose to the challenge. It accomplished a truly remarkable legislative achievement: the Garn-St Germain Depository Institutions Act of 1982. For thrift institutions it provided both the capital assistance mechanisms and the asset diverisfication opportunities to permit us to fulfill our residential housing commitment to you and the American people.

It is now our fervent hope that we can work together in this new Congress to assure that homeownership in our nation—the envy of the world—can remain an achievable goal for families and our society.

Thank you for this opportunity to present these views. I look forward to your questions.

The CHAIRMAN. All of you expressed a somewhat hopeful view for an upturn in the housing and also in housing finance. Do you believe that your institutions will be able to supply the mortgage credit needed to finance the roughly 1.3 to 1.6 million housing starts we've been talking about today plus existing housing? Mr. Shane?

TRILLIONS OF DOLLARS NEEDED

Mr. SHANE. I would say to you that the needs which are in the trillions—we're talking about a $3½ trillion portfolio and a need for an excess of a trillion dollars in the next 5 years—cannot be supplied to the extent that would be acceptable to you or to me, Mr. Chairman, as part of the American dream under the present scenarios we see.

Interest rates are too high; maybe they will come down. The shortage of long-term capital which I attempted to discuss, the entire crowding-out process—the secondary market can take care of a little of it, but not to the extent we dream about, Mr. Chairman. We have to make some——

The CHAIRMAN. Do you have comments on that particular question, so that we can meet at least the minimum 1.3 to 1.6? Mr. Wooten?

Mr. WOOTEN. I would make a comment that perhaps it isn't just a source of funds, but it's the vehicle and the transition of the type of instrument, the type of lending that's being done.

We experienced that last year in my company, that has loan production over some 45 States. So I think it would be relatively typical where we were able to develop adjustable rate market; it was a great aid to negotiations with Mr. Maxwell of Fannie May as a backup.

But subsequent to that period, after we had developed some $350 million of these in a period of about 6 months, we have been able to find short-term thrift institutions interested in these loans, to the extent that we have marketed into those institutions some $180 million of those loans.

So I suggest it isn't just the same old product and the same old source—we're broadening the sources, and an amendment to the type of vehicle, that we can start to deliver.

Mr. KENDALL. Senator, I would say the way we financed housing in the 1970s probably was 70 percent through deposit institutions, 30 percent through what we call secondary markets. It's been my belief that before too many years pass, those are just going to reverse, and 70 percent of the money would have to come from linking national capital markets to the local home mortgage market, even though the local insititution would be the originator and servicer of the loan.

Today I think we're probably about at 50–50. We need help relative to a recognition of that principle through things like you discussed earlier: The pension fund money, international investors, people of that sort who will buy mortgages in securities form, if those of us sitting at this table and others like us can—are given the freedom with which to work.

I think 1.3 to 1.6 million housing starts we can do with a minimal amount of encouragement and help from the regulatory authorities and Congress.

Mr. SHANE. I agree with the 1.3, I was addressing 1.9. I think that was the question.

Mr. GRAY. I would believe what's been said, particularly that depository institutions will continue to make the loans, because we do

have to have the ability to sell to the secondary market at this point in time.

The CHAIRMAN. Let me make one more comment, if I may, in response to Mr. Shane about changing markets. Obviously, the accounts have been more successful, the NEW accounts, than anyone anticipated.

As much as we might like to go back and do something with money market funds, drawing on my own personal experience in my own State legislature, as to whether that should have been done or not, whether deregulation was better than regulation of the new boys on the block, I would suggest that it was a political impossibility to do so.

Concerning the possibility of putting reserves on money market funds, interest rate savings and so on, I don't think you could have gathered 20 votes in the Senate for that type of approach.

LOOKING FOR NEW SOURCES OF MORTGAGE MONEY

What I think this Committee is trying to do, and the reason we put so much stress this morning on pension funds, is looking for new sources of mortgage money to stimulate the housing sector and the jobs that go with it: I think the marketplace is not being changed by the legislation that comes out of this Committee.

We have in the 8 years I've been here usually been well behind the power curve in responding to what has already taken place in the marketplace. That was true of the depository institution deregulation, the Monetary Control Act of 1980. We talked about it for 3 or 4 years. Finally in this very room, after an extension, because of court decisions we passed that Act.

So we normally have not been very forward-looking, and the marketplace is changing. Money market funds were real technology changes. Electronic funds transfer and all the things that are going on are literally mind-boggling. It happens in the marketplace.

So we can wish for easier times with people nicely compartmentalized. I think this committee has to continue to try and look for new sources of housing money because I agree with all of you, it isn't the legislation that's mandating those changes and the mix that was going on before the legislation was ever passed. Those sources are not within this committee's jurisdiction. We're starting to deal with tax revenues and changes in ERISA and so on that are in other committees.

Our function in looking for those is to jawbone, as we did this morning, and to talk to Senator Dole, the chairman of the Finance Committee, as I have been doing—I'm withholding its source. I would like to tell you that everybody in this country thinks that Jake Garn is responsible for that because it is the Banking Committee.

I clearly tell them at least, call Senators Dole and Rostenkowski, Ways and Means, and Finance; it's not this poor committee that has done that to the country.

But each of you gentlemen were very kind in shortening your statements. I will submit the rest of my questions to you for your response.

Senator RIEGLE. Thank you, Mr. Chairman.

It seems to me what has been clear in observing and hearing what the witnesses have been saying to us today is that there is an enormous structural change taking place that bears on this whole question of housing and how much is going to be available, what is it going to cost, and what it is going to look like, and how many people can afford it, and so forth.

I don't know that we have yet grasped fully the dimension of the structural change that is upon us. Mr. Pratt rattled off the notion of houses that might be 800 square feet to 1,300 square feet. I notice that my colleague Senator Lautenberg's eyes widened. That is a real change from what we have thought about in the past, and I think it goes fundamentally to the question of national goals and purposes.

Every once in a while we get past the details of issues and down to some very fundamental national question, and I think we are now approaching a very fundamental national question. That is, where does homeownership fit into our national structure? To what extent should national policy try to facilitate homeownership? Do we want to accommodate that somehow in the scheme of things?

In years past we had a number of devices for doing that. We are very much aware that the financial and savings system is structured and the limitations involved and tax policy were all geared to facilitate homeownership because I gather that that was the strong feeling in the country at that time, and that is one of the central goals we want to pursue as a society.

We did remarkably well, but I think your point is well-taken in the recent data that you were saying, Mr. Shane, that having got up to the point where we had 65½ percent or thereabouts of our families in their own homes in 1980, the trend is now turning, it is going the other way.

And all of the rest of this panoply of forces raises the question of whether or not we may not find ourselves moving away from home ownership as a practical goal for an increasing number of American people. I am very much concerned about that.

It would be much harder to get that kind of a debate focused and structured in terms of what is it that we want to see as an end result than it is to just talk about all of the incremental changes on the margin and all the myriad bits and pieces that bear on housing.

I don't know that we will collect it all in a nice, coherent whole form so that we can make some national judgments, and that worries me, because I think this is the kind of question now that is really important enough that it deserves adequate focus. So we will just have to strive for that as best we can.

DIFFERENCE IN CREDIT AVAILABILITY

Now in terms of availability of credit, in your presentation, Mr. Shane, you talk about the difference between credit that is available for housing versus homeownership and the credit that is available for commercial and industrial uses, and you were saying in effect that you don't think the competitive pressures coming from those two different sectors, competing for the same pool of money,

are the same, and suggesting that homeownership and the people who are seeking credit for that purpose tend to have a tougher time getting it.

Am I right in that inference?

Mr. SHANE. They are essentially the only two major forms of credit we have in this country, credit that is used for commercial-industrial purposes and credit that is used for homeownership.

There is a substantial difference, Senator Riegle. The difference is this. A homeowner, utilizing a major form of credit to purchase a home, has to qualify for a loan, has to pay it back out of his own resources over a long period of time, and the use of those funds affects his lifestyle.

His competitor for those funds, the commercial and industrial user, is able to acquire those funds and consider the cost of them to be a cost of goods or services, and it becomes part of a pricing mechanism without individual necessity for qualification.

So that if you eliminate the qualification aspect, put it into a pricing mechanism, as interest rates go up—and this was the point that was made this morning several times. When you go to 14 percent, you shut off many homeowners, 15, the potential goes down, or down to 9 the potential goes up. But in terms of the utilization of credit for commerce and industry, those that need it can pay for it at that level, and properly so, as part of the pricing mechanism.

So the use of qualification on the part of the borrower shuts out the availability even to apply in the homeownership sense. It is different. It cannot compete in the open market.

Senator RIEGLE. I was struck, too, by the point I think Mr. Gray made. In addition just to the backlog of people who are waiting to buy homes that have been held back because of recession, unemployment, and so forth, there are also a lot of variable rate rollovers. So we are talking about a whole new type of surge demand for housing credit.

I had hoped to get more of that from the Secretary in terms of his expectations for housing needs. It sounds to me like we don't have a great fix on that.

In your discussion, Mr. Shane, you mentioned the mixed blessing of the new financial instruments, the S&L's and the other savings institutions, in that they are drawing in a lot of money, but are paying a lot for it because it is a 1-day account.

Are you suggesting that we ought to think about some other regulatory device here? Should we double back on ourselves? What is the implication of raising the red flag about that in terms of what should we think about doing?

Mr. SHANE. First of all, Senator Riegle, under no circumstances would I want you to interpret my remarks as saying let's go back to anything, because I am not going back in terms of attempting to analyze.

PREDATORY PRICING

But I think the first step is understanding the phenomena that has taken place in various parts of the country. In the very extreme we have had predatory pricing in some parts of the country that is mindboggling.

There have been several areas in which the offer of interest, to get a share of the market, has exceeded the prime rate that a commercial bank will charge to lend that money.

The CHAIRMAN. Excuse me, Mr. Shane. Wasn't that just for very brief periods of time, like 2 weeks or a month?

Somebody in the District was offering, I think, 21 or 22 percent. Reading the fine print, it was for 2 weeks.

Mr. SHANE. Well, what has happened is we have had predatory pricing, and there is still substantially above-market pricing. Various parts of the country have represented different things.

I consider 15 percent to be predatory pricing that we set, out on the west coast; it might have been a low rate in the District.

The fact is that this is money that has a different characteristic.

So to answer your questions, Senator Riegle, I guess what I am saying is that we are about to begin to understand the magnitude of the phenomenon that we weren't even anticipating.

I can't sit here before you today and tell you what it is going to look like a month from now. I guess I am just ringing an alarm bell.

If we wind up with 50 percent of the deposits in this country in short-term accounts, we are together—our Congress and our citizens and our leadership—going to have to figure out how to cope with the long-term capital needs of the country. I don't think it means going back to anything.

But we accomplish nothing by failing to recognize the magnitude of a new phenomenon, and so it is an alarm bell, Senator Riegle, without a solution.

The CHAIRMAN. Will the Senator yield for one more quick question?

Senator RIEGLE. Yes.

ONE DAY ACCOUNTS

The CHAIRMAN. I certainly agree with your point that it is 1-day money, but traditionally the S&L's, the vast majority of their accounts were normal deposit accounts and that was 1-day money too. The difference is you had an interest rate ceiling on it.

So I don't quite understand the point that this is any more volatile. You are paying more for it, but you are also, all of you out there, devising the most intricate sweep accounts I have ever seen.

I mean, I don't know how you even administer those sweep accounts, the big advertising——

Mr. SHANE. I don't either.

The CHAIRMAN. So I don't disagree with what you have said, but it seems to me new accounts are 1-day accounts, like most of your traditional passbook accounts, always where people could take them out. You could enforce the provision in it, but you never did; you let them have their money instantly. And you had interest rate ceilings to protect you.

But here these sweep accounts are the most incredibly complex things I have ever seen. This must be a lot easier to manage.

So I agree with what you have said about your concern. It seems to me those were there anyway, and this is a much simpler way.

Mr. SHANE. Senator, may I respond to that, please?

First of all, the sweep account isn't even needed anymore because the new account takes the place of it.

The CHAIRMAN. I understand. That is my point.

Mr. SHANE. Senator, in the requirement in which you have the stable passbook account that went on year after year after year, you had a totally stable interest rate environment. While it may have had a ceiling, it was a ceiling during a period of time when that was very close to other costs of funds, and the variations from year to year might be a quarter of a percent or less.

We are now in a totally different kind of environment, totally different kind of interest rate sophistication, and what has gone into the new accounts, in addition to the new funds, has been money coming out of term accounts, not out of passbooks. The passbook died years ago.

So we are talking about changing the characteristics of the portfolio in an interest rate-sensitive market to an interest rate-sensitive account.

Now some of that money is going to have portfolio characteristics. Please don't misunderstand me. We just don't know what it is yet.

We are all in a totally uncharted, unanticipated thing. If this account had produced 6 or 7 percent of portfolio, which is what some of the economists were estimating, we would have a different situation.

But instead, it is producing something that is beyond anybody's expectation. Again, I want to reiterate, I am not proposing a course of action or a rollback or anything. I think I am obligated as a citizen sitting before you to ring a bell and say, "This is something you weren't expecting, gentlemen, nor were we."

Senator RIEGLE. If I may, just one last question. I would like you to take the concern that you have, your observations and try to convert that to what it is going to mean for housing. In other words, is it your intuition or your concern here that this is going to lead us to more housing mortgages, to the same number of housing mortgages or less?

In other words, what is likely to be the bottom line in terms of being able to go out and finance mortgage credit ease so that more people can afford housing?

Mr. SHANE. Preconditioning my response, Senator, is that we are assuming an interest rate environment that would be favorable in any event, a reduced interest rate environment, because an increased interest rate environment makes the question moot.

The home market can't qualify, so it is out of the question.

Senator RIEGLE. We are not that far away from that tip point now. The rates are 10 percent. You don't have to get much above that——

Mr. SHANE. I heard 9 percent this morning. I hope the Secretary was right. I am not sure we are going to see conventional 9 percent rates very soon.

But given a marketplace where you might normally expect *x* percentage of the portfolio to go to homeownership and given the new configuration of the accounts which we have to learn, we have to learn its characteristics, its portfolio characteristics, and we will learn it.

There is every reason to believe that in the competitive area for credit that the absence of certificates or some form of longer term account that gives you a longer term maturity will cause you to have to deal with a mortgage instrument that has enormous flexibility attached to it because we are only intermediaries.

That being the case and the secondary market being the smaller portion, as it really is, the Fannie Mae/Freddie Mac, they are dealing primarily—Freddie Mac is a sinner in this is my judgement dealing primarily within a fixed rate loan; because of their inability to administratively get beyond that. Fannie Mae has done a good job.

The number of dollars that we transmit from the investor to the borrower would be less than you otherwise would anticipate, given the short maturity.

I think that it is going to turn out to be beyond question.

Senator RIEGLE. It seems to me that is pretty significant, bottom line.

Mr. SHANE. It is a fearsome one, yes, sir.

The CHAIRMAN. Senator Hecht?

CHANGES MUST BE MADE

Senator HECHT. Mr. Shane, I enjoyed your report. I share your concerns. You have rung the bell, and when Senator Garn asked you, you made the statement "We must make some changes," but you stopped short.

What changes do you think we should make right now?

Mr. SHANE. Senator, I do not, in all honesty, know the answer. The new environment that we are in now is about 8 weeks old, and only 4 of those weeks have really registered in terms of the economic circumstance.

Our trade association, which has a great deal of resources, has appointed a task force of the best brains that we have, and we have hired some of the best researchers available to attempt to clearly define the questions.

And we are going to hope to have a report of some significance within 180 days. We have told our compatriots what we are doing, and we have invited them to help so that we can define these new questions—and they are new, Senator—and hopefully propose some parameters for developing some answers.

I do not pretend to have the answers today, Senator. This is too new.

Senator HECHT. Thank you.

Mr. GRAY. I might just say to that, I think it is going to be a long time before we really do know. They are going to try to come up with some ideas in 180 days, but I don't think we are going to know what this new account is all about for a lot longer period of time than that, and I think Mr. Shane agrees with me.

Mr. SHANE. I agree with you.

Senator HECHT. May I ask, Mr. Wooten, how about yourself, the changes?

Mr. WOOTEN. I share firsthand the confusion that the thrift industry has over what to do with this money. As one fellow said, it might be smart to give it back. [Laughter.]

I think mortgage bankers are innovators and entrepreneurs, and we are working on different things that we think perhaps might help thrifts cope with their ability to profitably employ those funds with the flexibility and agility that they need.

If they don't discover it, I think we are trying to find it in some of the things we were able to do last year. Different kinds of investible financing are the answer. It has got to balance out in each firm in a spread that makes them profitable.

If the thrifts are not profitable and don't survive, they can't help housing. So, of course, we have got to get them around to that posture before we can work on it. We don't have the answer to it, but we are going to spend an awful lot of time working on it. We are middleman—they moved—we are going to move over and get back in the middle.

The CHAIRMAN. Senator Lautenberg?

Senator LAUTENBERG. Thank you, Mr. Chairman, may I ask you, sir, is the next hearing going to be sequential?

The CHAIRMAN. It is supposed to start at 2 o'clock, international finance.

Senator LAUTENBERG. So we don't have much time?

The CHAIRMAN. It is with Secretary Regan, so I am trying to speed things up.

Senator LAUTENBERG. I will be relatively brief.

The CHAIRMAN. We have had Treasury Secretaries wait before. [Laughter.]

Senator LAUTENBERG. Briefly, concerning your statement on the Volcker summary. I thought very interesting, the whole morning for me has been a very interesting one. I have learned a lot about a business that I thought I knew a little about, and I am now persuaded that I knew less than I thought I did.

Mr. SHANE. We give private tutorials, Senator.

Senator LAUTENBERG. I am curious about a couple of things. One, is that there seems to be a differing view between the first panel and this one in terms of the general optimism about where we are going vis-a-vis the recovery.

You, Mr. Shane, seem to place it on a little thinner ice on what we heard earlier today.

You picked upon my surprise concerning the statement that there were a lot more fixed term long-term mortgages being picked up than the variable rates. I would love to see that happen, but I don't know who is going to take the responsibility for the investment of the funds that are made available for those institutions that have to be paid back.

Mr. SHANE. Senator, may I give you a statistic on that? You were not misled, but there was a warped statistic this morning.

In terms of those secondary markets, which are a small part of the total marketplace, it is quite correct that they are doing more, but in 1981, 46 percent of all loans originated by savings and loans in this country, applicable to the time when there were some legal constraints in some places, were in one form or another an adjustable mortgage instrument—46 percent in 1981.

We have savings and loans, including some of the largest in the United States, who originate only flexible loans; they can make no other loans.

Senator LAUTENBERG. I believe that. I have had visitors from the industry, and in fact one very large firm in New Jersey said, "All we are doing is servicing these things; we are not keeping them. We are taking the service items and moving them on."

Yes, sir?

Mr. KENDALL. Senator, the growing parts and other parts of the market do want to hold fixed term and fixed rate mortgages because that is what is best for them. The pension fund has a requirement to fund an obligation in, let's say, 10 or 15 years for people who are 45 and 50 years of age.

They know that their requirement, let's say, is 8 percent. That is the actual requirement they have to hit. If they could get a 12-percent contract that would last 10 years and, so to speak, lock in their obligation on a given number of lives, they are more than willing to do it.

They purchase fixed rate Fannie Mae contracts. They purchase from companies like mine, Maggie Mae, which is the same kind of contract, and then if you move over to the revenue—housing revenue bond area, the bondholder, who is probably an individual, wants a 10-year, 15-year obligation that has a 10-percent rate on it, not a variable rate.

So I agree fully with what Leonard said. A deposit institution with short-term liabilities that lived through the chaos of the last period of years is not quick to get back into this.

However, as you move toward the capital market, the balance, with Jim Wooten and Herb Gray and others sending those mortgages over there, provides those. I would note even Leonard's figure—the other side of that—50-some percent were still fixed rate mortgages—probably short term, but fixed rate mortgages.

Mr. SHANE. Oh, sure.

CHANGE IN THE AMERICAN DREAM

Senator LAUTENBERG. Fine. One last thing. Are we seeing such a change in the American dream, as you defined it and as people in the housing-related industry define it, the dream of owning a house? Are we seeing that dream not being fulfilled or not so much the dream that it used to be because there are other things that occasion. I believe, one of the reasons for a lower percentage of home ownership other than that which you have used as a barometer, or a yardstick, is the cost for heating homes, which I believe to be an enormous factor?

We see it out in the northeastern part of the country. It is dissuading homeownership no matter what, in many cases, interest rates or real estate taxes. As there is less help from the Federal Government communities have to pick up a larger share.

These are great disincentives to homeownership. The other thing is, that as our population age changes, as demands change and as transportation costs change, prohibiting people from getting further out. We are also seeing dramatic increases in commuter fares. What is the change that we are looking at over the years in terms of the demand for individual homeownership?

Is that being studied? Is that being reviewed in terms of what we can expect?

Because I think there is a tendency here—maybe, Mr. Chairman, that is the purpose of the hearing—is to focus solely on the interest rate side of things. I think there are factors other than interest rates that reflect what people think in terms of defining their American dream.

Mr. SHANE. The most definitive study of that type was the one that was done by Fannie Mae that Mr. Maxwell referred to this morning. It has become, in effect, the basis for a great deal of economic planning for a great many industries, and that is the continuing overwhelming desire on the part of apartment dwellers to own homes and the overwhelming desire on the part of homeowners to upgrade.

Mr. GRAY. It seems to me the demand is there. It's a very real demand out there. The question is whether we can deal with the expectations. If we can deal with the expectations as to the type of housing people want, I am sure that we can both meet their housing needs and provide the capital and provide the jobs they need to pay for the housing.

The CHAIRMAN. Thank you very much. Senator Lautenberg, you've added a great deal, and you should not be so modest about what you are contributing to this committee.

Senator LAUTENBERG. I'm contributing the use of time, I know that.

The CHAIRMAN. You've been asking some very good questions, and we appreciate that.

Gentlemen, thank you very much. We will have additional questions for you in writing.

If we could have the final panel, panel No. 3, come up. Mr. Harry Pryde, Chairman, National Association of Homebuilders, Harley W. Snyder, president, National Association of Realtors, Henry Schechter, director of the American Federation of Labor/Congress of Industrial Organization.

STATEMENTS OF HARRY PRYDE, CHAIRMAN, NATIONAL ASSOCIATION OF HOME BUILDERS; HARLEY W. SNYDER, PRESIDENT, NATIONAL ASSOCIATION OF REALTORS; AND HENRY SCHECHTER, DIRECTOR, AMERICAN FEDERATION OF LABOR/CONGRESS OF INDUSTRIAL ORGANIZATIONS

The Chairman. Mr. Pryde, would you like to begin?

STATEMENT OF HARRY PRYDE, CHAIRMAN NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. PRYDE. Members of the Committee, Mr. Chairman, my name is Harry Pryde. I'm a builder/developer from Seattle, Wash.

I'm testifying as president of the National Association of Home Builders on behalf of more than 105,000 members across the country. Mr. Chairman, I want to commend you for calling this early and timely session to explore the extent and duration of the housing recovery.

Let me take this opportunity to welcome the six new members of the committee, especially the new member from my home State of Washington, Senator Slade Gorton, who I understand could not be here today.

I think this is a tribute to you, Mr. Chairman, that you've had so many members seeking to serve on this committee. I think it also perhaps indicates a greater emphasis than in the past on the area of housing.

I hope that this will be an indication of the importance of housing to a sustainable economic recovery this year.

With that said——

The Chairman. If I could interrupt you here. Let me say that I think you are entirely accurate. We are really pleased with the quality of the new membership on the committee this year. I don't think it has anything to do with me. I think it has to do with economic times and problems, and the Banking committee is more in the forefront where those problems and changes are occurring.

We do have six new members of the Banking Committee that I'm very proud have wanted by choice to serve on the Committee.

Mr. PRYDE. With that said, I guess I might start off by saying. "How do you describe the housing recovery which already has received so much attention as one of the only bright spots in the economic picture?"

RECOVERY FRAGILE, BUT REAL

I would say that the recovery is modest, fragile, but real. The signs are mixed, pointing upward. I think it's important to remember that in 1981 and 1982, we had two of our most disastrous years with production down below 1.1 million. Actually last year, 1.07 million. Home sales were at the lowest level since the Census Bureau began its sales survey in 1963. Construction unemployment averaged 20 percent, the highest levels since the Bureau of Labor Statistics began its monthly unemployment survey in the late 1940's.

Mr. Chairman, you can say that we in the housing industry, with the exception of some of our builders from Texas or other isolated areas, are glad that 1982 is behind us.

At this time, mortgage interest rates are between 12 and 14 percent. FHA rates are at 12, conventional rates are 13 to 14. We've had an increase over the past 2 weeks of three-quarter of 1 percent in the long-term rate. We hope that's a temporary aberration, but I must say that our builders are still buying down loans to between 10 and 11 percent. I wouldn't necessarily agree with some of our earlier speakers that the threshold is 12 to 13 percent. I would say it's lower than that, more like 10 to 11 now. That's probably due to many reasons. We do have our builders out there starting houses, with the hope that interest rates will come down further.

I want to bring to your attention that this is the first time that we have had a recovery taking place without any type of Government assistance, such as Brooke-Cranston or tax credits. This may account, in part, for the slow pace of the recovery.

Our forecast for this year developed by our economics department is 1.39 million a little less than 1.4 million starts. This is based upon a number of assumptions: interest rates will come down, Treasury bills will come down another point, the prime rate will come down to 9 percent in the fourth quarter, and FHA rate will come down to 10 or 10½ percen by the end of this year.

Most forecasters have been projecting housing production in the range of 1.3 and 1.4 in 1983. At that level, this industry can only be expected to make a modest contribution to the recovery of the overall economy this year. If housing production were to increase by 320,000 in 1983, this would translate into an increase of 28 percent on a GNP basis for residential construction, or some $27 billion in fixed residential investment.

But I must bring a note of caution to this discussion. We still feel that interest rates have to come down. If they were to go up, or if the Federal Reserve Board returns to strict monetarist polices or if the federal deficits remain in the $200 billion range for the next few years, our forecast would be as pessimistic as the actual levels of activity we had for 1981-82.

The budget area is probably the greatest concern to us. We're deeply troubled by the Administration's fiscal year 1984 budget which projects deficits in the $190 billion range. Budget deficits are still projected at $116 billion in fiscal year 1985 or 1988 after 5 years of relatively strong GNP growth of 4 percent annually. Of course this budget deficit is based upon Congress accepting all the administration's proposals on spending and taxes. What's more frightening are the Congressional Budget Office's out year baseline projections for fiscal 1988 of a deficit of $267 billion, based on a 3.8-percent increase in real GNP growth and assuming no changes from fiscal year 1983 programs.

Deficits of this size can only open the door to, we feel, a serious credit crunch in the near future which would weaken, if not destroy, the recovery underway.

REDUCE PROJECTED DEFICITS

In order to reduce these projected deficits, we think you have to get into the big ticket items like national defense and entitlement programs this year. We feel basically that Congress and the administration need to come up with a credible plan this year to cut deficits, or we won't have a sustained economic recovery. And if the Government continues to take 6.5 percent of the gross national product and 40 or 45 percent of the credit market, there just won't be sufficient credit to accommodate all sectors of the economy. Then highly sensitive sectors such as housing, small business, and farming will be preempted from the financial markets by others, especially the Federal Government.

At the same time, we can no longer remain silent as the Federal commitment to housing for those in need has been virtually wiped out. I do not intend to discuss the details of the housing authorization program at this time. However, the administration's proposed cut of 94 percent in new budget authority for assisted housing for fiscal year 1984 is dramatic. We've had a reduction from 4.2 percent of the Federal budget in fiscal year 1980 to 0.1 percent for housing in fiscal year 1984.

The successful rural housing programs of the Farmers Home Administration will be virtually zeroed out in fiscal year 1984.

Finally, Mr. Chairman, you have asked us to comment briefly on the state of the housing delivery system. Because of time constraints, I will review that very briefly.

We have certainly had a revolutionary change take place in delivery systems. Based upon statistical analysis in my testimony, you can no longer assume that thrift institutions will provide an adequate share of mortgage money in the future. We've seen them go from 57 percent in 1976 to 13 percent in 1981.

Maybe the S&L's are becoming more profitable. I can't necessarily say that's happening to the housing industry at the present time.

We feel that the mortgage-backed security programs provide the greatest potential for accessing new sources of mortgage funds, especially in the areas of pension funds. As for our housing product, there is a definite trend to smaller homes. We see that across the country. Single family detached are being built as small as 800 square feet, condominiums as small as 300 square feet, and those type of houses are selling.

In the area of production capacity, on the whole, we do not expect much pressure on the supply of either labor or materials in 1983. There was a dramatic increase in lumber prices between November and January of this year of about 30 percent, but that has come down to about 20 percent now. So there has been a reduction of almost half of the increase that took place earlier this year and in the latter part of last year.

In conclusion, Mr. Chairman, I am aware that you asked us to avoid discussing specific housing authorization recommendations today. I look forward to appearing before your committee next month on those issues. However, I would like to submit for the record a brief outline of our key legislative priorities for this year which are attached with our policy statement in the appendix of our submission. And I might add that we are supporting a mortgage interest tax credit, as proposed by the President's Housing Commission.

I believe that our legislative agenda reflects the concerns I've raised in my testimony today.

It's been an honor to appear before your committee today. I do not envy you your task this year. Indeed, the future of our industry is in your hands, along with the Fed and the administration during the next few months.

We stand ready to assist you and your highly competent staff in any way we can.

Thank you for allowing me to appear today.

The CHAIRMAN. Thank you, Mr. Pryde.

[Complete statement follows:]

STATEMENT OF

THE NATIONAL ASSOCIATION OF HOME BUILDERS (NAHB)

before

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

on

STATUS OF THE HOUSING INDUSTRY

on

February 14, 1983

Mr. Chairman and Members of the Committee:

My name is Harry Pryde and I am a homebuilder and developer from Bellevue, Washington. I am testifying on behalf of the more than 105,000 members of the National Association of Home Builders (NAHB). NAHB is a trade association of the nation's homebuilding industry, of which I am President. Accompanying me today are Robert D Bannister, Senior Staff Vice President for Government Affairs, Dr. Michael Sumichrast, Senior Staff Vice President and Chief Economist, and Jim Schuyler, Staff Vice President and Legislative Counsel. I am pleased to be here to testify on the status of and outlook for the homebuilding industry.

Mr. Chairman, I commend you for calling this early and timely hearing to explore the extent and duration of the housing recovery and its implications for the overall national economy. Let me also take this opportunity to welcome the six new members of the Committee who bring new blood and, in the case of my home state Senator Gorton, geographic balance to this important Committee. It was heartening to

learn that this Committee was a popular choice this year, with more Members seeking to serve than could be accommodated. Mr. Chairman, that situation is a tribute to your leadership and, I hope, recognition of the importance of housing to an economic recovery this year. I am also pleased to see Senator Proxmire return to his thoughtful and customary role as ranking Member on the Committee.

STATUS OF THE HOUSING INDUSTRY

With that said, Mr. Chairman, my testimony becomes more difficult. How do you describe a housing recovery which has already received much attention as one of the only bright spots in the economic picture? I would say the recovery is modest, fragile but real. The signs are mixed, but pointing upward.

- Building permits for December rose at a seasonal rate by more than 8 percent from November. This represented the fourth consecutive month of increase, and suggests a fairly good January for housing production. The actual number of permits rose in the South and West between November and December. This increase in permit activity reflects the builder's sense of optimism for recovery this year.
- Housing production in December was down 13 percent from November, but up by 38.5 percent from December 1981. The seasonally adjusted annual starts for December were 1.2 million. Our Economics Division believes that this downturn reflects atypical November activity rather than a slowdown of the recovery. However, the December production level should temper the premature optimism that was generated by the 1.4 million November starts rate (see Table I).

- Sales improved dramatically in October and November but slowed in December. The November 1982 rate was the highest in two years, but December sales were nine percent below the November rate.
- The new unsold inventory is generally declining, with a slight increase from November to December. In December 1982, inventory stood at 250,000 or 5.8 months of inventory at current sales rate. The November inventory was the lowest since March 1977 (see Table 2).
- Construction unemployment still stood at 20 percent in January of this year, representing over one million people out of work. However, this has dropped from a peak of 22.3 percent in October of 1982 (see Table 3).

In 1981 and 1982, the housing industry operated at its lowest levels of production since 1946. Starts in 1982 ended up at 1.07 million, about 46 percent below the peak of the previous cycle in 1978. New home sales were at their lowest level since the Census Bureau began its sales survey in 1963. Construction unemployment averaged 20 percent, the highest level since the Bureau of Labor Statistics began its monthly unemployment survey in the late 1940's. Mr. Chairman, you could say that we in the housing industry (with the exception of some of our builders in Texas and other isolated areas) are very happy that 1982 has ended.

At this time, mortgage interest rates are in the 12 percent to 14 percent range, substantially higher than rates in 1976 when the industry recovered from its last major recession (see Table 4). It should be noted that this modest recovery is underway without the

type of government assistance (Brooke-Cranston and tax credit for home purchase) provided to assist recovery from the 1974-75 downturn. That may account in part for the slow and modest recovery now occurring. In fact, our Economics Division has projected that government-assisted production of all types will be down by 50 percent from 1982 to 1983. And most of that limited activity in 1983 will be due to rural housing programs (see Table 5).

OUTLOOK FOR THE HOUSING INDUSTRY

Based upon NAHB's most recent econometric forecast, total housing production is expected to increase by 31 percent to 1.39 million in 1983. Single family activity is expected to reach 887,000 units with multifamily at 503,000. Our most recent forecast has shifted some units out of multifamily and into single family. This is based upon the assumption that multifamily production is not picking up as quickly as anticipated from the decline in Section 8 activity, while single family production is responding more quickly due to the interest rate decline (see Table 6).

Let me be specific about the assumption variables which were used to develop the forecast. We are assuming a decline in AAA bond yields and three month Treasury bills of one full percentage point between fourth quarter 1982 and fourth quarter 1983. The prime rate is projected to drop by almost three percentage points, from 11.96 percent in the fourth quarter 1982 to 9 percent in the fourth quarter of 1983. (see Table 7).

Mr. Chairman, most forecasters have projected housing production to range between 1.3 million and 1.4 million units in 1983. At that level, this industry can only be expected to make a modest contribution to recovery of the overall economy this year. If housing

production increases by 320,000 in 1983, that translates into an increase of 28 percent on a GNP basis for residential construction or $27 billion in fixed residential investment. This means about 540,000 manyears of employment in construction industries, plus an equal number of man-years in related industries. These are virtually all private sector jobs.

But I must bring a note of caution to this discussion. If interest rates begin to head upward ... if the Federal Reserve Board returns to its strict monetarist policy ... or if federal budget deficits remain in the $200 billion range for the next few years ... our forecast would be as pessimistic as the actual level of activity in 1981 and 1982. That is why I called this recovery fragile ... as fragile as the cherry blossoms which sometimes offer picture postcard beauty to this city in April.

BUDGET

Let me first focus on the federal budget for FY'84 and beyond.

Mr. Chairman, I am deeply troubled by the Administration's FY'84 budget which projects deficits in the $190 billion range for FY'84 and FY'85. The budget still projects a deficit of $116.7 billion in FY'88 after five years of relatively strong GNP growth of four percent annually. Of course, that budget deficit is based upon Congress accepting all of the Administration's proposals on spending and taxes. Even more frightening are the Congressional Budget Office out-year baseline projection of an FY'88 deficit of $267 billion assuming no changes from FY'83 programs and a 3.8 percent annual rate of GNP growth (see Table 8).

Deficits of that size could only open the door to a serious credit crunch in the near future which would weaken, if not destroy, the recovery now underway. In order to reduce these projected deficits, we believe that Congress and the Administration must focus on the "big ticket" items which have been ruled off-limits from the budget process. This must include scaling back on defense spending and containing the soaring costs of entitlement programs. These programs, coupled with interest payments on the national debt, account for over 80 percent of the federal budget (see Table 9 and Chart I).

Large deficits have an impact on available savings. In the past two years, credit markets were able to raise just under $500 billion each year in new funds, with the federal government taking over $200 billion in 1982 (see Table 10 and Chart 2).

Current projections of the deficit mean that we would have to finance 6.5 percent of the GNP for the federal government alone. This would reduce net investment and weaken if not abort the prospective recovery.

Large deficits also affect the financial markets. They spell uncertainty and grave concern for the money managers as to the direction of long-term government policies. Deficits result in higher interest rates, undermine our trade balance and create a climate for worldwide protectionism.

Let me again stress the importance of working to reduce the federal deficits. I fear that by late summer or early fall the financial markets are going to be under the combined pressure of both the government and the private sector of the economy. And if the government continues to take 6.5 percent of the GNP, then you can be

sure that there is not going to be sufficient credit for all sectors of the economy. The highly credit sensitive industries, such as housing, small business and farming will be pre-empted from the financial market by others, especially the federal government.

At the same time, we can no longer remain silent as the federal commitment to housing for those in need has been virtually wiped out. I do not intend to discuss the details of housing authorization programs at this time. However, the Administration proposes a cut of 94 percent in the new budget authority for assisted housing for FY'84. Assisted housing, which represented 4.2 percent of the federal budget in FY'80, would slip to a 0.1 percent share in FY'84. The successful rural housing program of the Farmers Home Administration would be virtually "zeroed out" in FY'84. The replacement proposed by the Administration is an unworkable block grant to the states at about 25 percent of FY'83 financing (see Table 11 and Charts 3 and 4).

Mr. Chairman, I urge this Committee to review carefully the budget comparisons we have prepared which are attached to my testimony. The share of the budget consumed by national defense would increase from 22.1 percent in 1980 to 31.2 percent in 1984 (and 33.8 percent in 1986) under the Administration proposal. We ask you to review comparative changes in functions in the entire federal budget before you make your recommendation to the Budget Committee regarding assisted housing and mortgage credit programs. I think you will find that housing is no longer being asked to bear a disproportionate share of budget cuts ... the program is better described as euthenasia.

THE DELIVERY SYSTEM

Finally, Mr. Chairman, you have asked me to discuss the state of the housing delivery system. Change -- some have called it revolutionary change -- is the only way to describe our current condition. First, there have been several major changes in the mortgage market.

MORTGAGE CREDIT

A. The share of total mortgages advanced by the thrifts dropped to minus 49.7 percent in the third quarter of 1982 from a peak reached in 1976 of plus 56.7 percent. Or, to put it another way, in 1976 nearly 60 percent of all mortgage money (nearly $50 billion) came from the thrift industry. In 1977, this share dropped to 50 percent while the total amount increased to $64.9 billion. By 1981 the share of the S&L mortgage advances dropped to 13.7 percent, or only $15.8 billion.

More mortgage money is coming from households (up to 20.3 percent in 1981). Mortgage pools, which were non-existent in the early 1960's, jumped to 13 percent of the share in 1981 and were up to a 61.0 percent share of the advances in the third quarter of 1982. (see Table 12).

We can no longer assume that the thrift industry will provide an adequate share of our mortgage money in the future.

B. Interest rates reached new record levels. Last Spring, conventional mortgage rates were quoted at close to 20 percent. Even today the FHA rate of 12 percent is very high by historical comparison. We cannot expect mortgage rates to decline to the 5 percent to 6 percent levels that we knew years ago.

C. Mortgage instruments have changed drastically. Today we have dozens of variable rate mortgages. Four years ago most of these instruments were unknown.

At the same time, homebuyers at the lower end of the market returned in record numers to FHA-insured and VA-guaranteed fixed-rate long-term loans (see Table 13 and Chart 4). There is still a consumer preference for the fixed-rate mortgage. In March a survey showed us that one-third of the builders were offering fixed-rate mortgages; in October the number jumped to nearly 70 percent.

D. Long-term money is no longer readily available for mortgages. The mortgage markets are looking for additional long term capital. They have to look to sources other than the savings and loan associations. The mortgage backed security provides the greatest potential for accessing new sources of mortgage funds.

E. HOME MORTGAGE ACCESS CORPORATION

As our good friends at FNMA and The Mortgage Corporation have already discussed, NAHB has established a new subsidiary known as HOMAC. HOMAC will access mortgage money for builders through the secondary market entities. This will give builders direct access to the capital markets without having to go through other financial intermediaries. HOMAC will also provide wider diversity of mortgage programs, greater flexibility in the delivery system, and economies of scale.

THE HOUSING PRODUCT

The average size of a new single family home increased from 912 square feet in 1950 to a peak of 1,655 square feet in 1978. In 1981 it dropped to 1,550 square feet. However, that doesn't tell the whole story (see Table 14).

Major builders are downsizing single family units by 300 to 500 square feet and townhouses by 200 to 300 square feet. This is no longer a gradual decline, but a major change.

The reasons are obvious: smaller families, reduced incomes, increased costs, higher utility bills, higher interest rates, and fewer children.

Additionaliy, there is the trend toward greater density: condominiums, townhouses, less land. And this also has meant fewer bedrooms, fewer bathrooms, and the change from expensive basements to slab construction. All of these changes have a major impact on the need for capital, materials and labor. The result of this trend, plus the lower inflation rate, is evident in the prices of homes. Between 1976 and 1979, the median price of new homes sold increased by over 45 percent; between 1979 and 1982 the median price increased by only 10.2 percent. In 1982, the increase was 0.6 percent (see Table 15).

Downsizing is particularly prevalent among the larger builders. Those who are building over 100 units report that 65.6 percent are shifting to smaller units, compared to only 25 percent of the builders who build fewer than 10 units. In addition, larger builders are also shifting to smaller lots more frequently and on a larger scale than are smaller builders.

Almost all builders are shifting into units with some additional luxury features and some (about 15 percent) are shifting to townhouses from single family detached homes.

PRODUCTION CAPAPCITY

On the whole, we do not expect much pressure on the supply of either labor or materials in 1983.

One area of concern is lumber. Lumber prices have already increased 22 percent since mid-November. They were up 37 percent in the third week of January from November, but declined in the last two weeks.

What this shows is the great sensitivity of lumber prices to housing production. It also shows the potential run-up in prices of lumber once homebuilding activity accelerates.

Lumber prices were very depressed in the past two years and a moderate improvement in prices will very likely reopen some of the mills that have ceased production. This would, of course, be beneficial to the West and South, where the bulk of lumber is being produced.

We are also concerned about the movement of protectionism and oppose the imposition of countervailing duties on the import of Canadian lumber. The Administration is considering action to impose such a duty, which would unnecessarily increase the cost of housing.

Lumber accounts for about 30 percent of the "hard cost" of a house. Let's say that a $70,000 home has a price tag of $10,500 for all lumber products. A 30 percent increase would add a direct cost for materials of $3,650. That alone, assuming that there is no other increase, would add 5.2 percent to the cost of a typical new single family home.

The reduction in the CPI, partly due to moderation in home prices, has resulted in lower interest rates. We must be careful not to reignite the upward trend in prices based upon increases in cost of labor or materials.

LEGISLATIVE PRIORITIES

Mr. Chairman, I am aware that you have asked us to avoid discussing specific housing authorizations recommendations today. I look forward to the opportunity to offer detailed suggestions next month. However, I would like to submit for the record a brief outline of our key legislative priorities for this year, along with the policy statement adopted by our Board of Directors in Houston last month (see Appendix A). I believe that our legislative agenda reflects the concerns I have raised in my testimony today regarding the outlook for the housing industry.

It is an honor to appear before this Committee today. I do not envy your task this year. But indeed the future of this industry and the overall economy is in your hands -- along with the Administration and the FED -- in the next few months. We stand ready to assist you and your highly competent staff in any way we can. I would be happy to answer any questions you may have.

TABLE 1

NEW HOUSING ACTIVITY AT SEASONALLY ADJUSTED ANNUAL RATES 1980-82
(In Thousands of Units)

	Private Housing Starts								Private Building Permits Issued					
		Starts by Census Region						Permits by Census Region						
Date	Total	Single Family	Multi-Family	North-east	North Central	South	West	Mobile Home Ship-ments	Total	Single Family	Multi-Family	North-east	North Central	South	West
1980									(16,000 permit issuing places)						
Mar	1080	644	416	113	171	508	288	230	988	576	412	123	131	462	272
Apr	1030	634	396	121	164	496	249	206	808	476	332	89	125	393	201
May	939	659	280	118	131	477	213	169	861	508	353	105	135	403	218
June	1196	775	421	126	189	628	253	171	1118	650	468	120	161	545	292
July	1273	862	411	116	192	674	291	207	1259	772	487	118	217	584	340
Aug	1418	982	436	131	215	695	377	215	1367	846	521	122	221	632	392
Sept	1463	1007	456	167	289	659	348	237	1484	881	603	136	239	722	387
Oct	1504	996	508	111	268	772	353	237	1366	824	542	135	240	631	360
Nov	1539	1007	532	123	313	740	363	239	1383	819	564	127	221	654	381
Dec	1457	927	530	127	247	769	314	239	1249	745	504	114	211	621	303
1981															
Jan	1585	974	611	156	305	834	290	232	1236	712	524	112	201	619	304
Feb	1294	835	459	104	190	723	277	254	1186	699	487	119	176	605	296
Mar	1318	863	455	129	220	693	276	255	1172	686	486	121	183	576	292
Apr	1301	868	433	122	205	673	301	265	1186	682	504	129	163	581	313
May	1172	776	396	123	178	605	266	262	1178	659	519	115	150	566	347
June	1046	705	341	98	159	542	247	256	986	573	413	110	138	470	268
July	1040	696	344	140	167	499	234	267	941	543	398	116	125	466	234
Aug	946	614	332	108	152	472	214	238	878	505	373	115	114	431	218
Sept	899	623	276	117	123	464	195	232	835	456	379	96	112	415	212
Oct	854	507	347	108	147	375	224	208	738	400	338	106	100	349	183
Nov	860	554	306	97	131	470	162	207	743	413	330	87	98	392	166
Dec	882	550	332	104	123	475	180	206	797	454	343	89	101	435	172
1982															
Jan	885	592	293	78	122	526	159	211	803	450	353	70	78	482	173
Feb	945	568	377	127	79	585	154	251	792	436	356	85	77	468	162
Mar	931	621	310	110	96	531	194	252	851	460	391	88	87	490	186
Apr	882	566	316	103	161	462	156	255	879	450	429	97	105	506	171
May	1066	631	435	124	146	602	194	246	944	488	456	110	145	488	201
June	908	621	287	91	160	458	199	257	929	516	413	105	118	499	207
July	1193	628	565	100	162	732	199	246	1062	500	562	101	140	555	266
Aug	1033	645	388	120	169	552	192	234	888	497	391	113	106	485	184
Sept	1129	677	452	151	136	614	228	222	1003	561	442	114	131	530	228
Oct	1126	701	425	102	158	610	256	218	1172	651	521	135	139	635	263
Nov	1404	883	521	175	183	811	235	246	1192	729	463	127	131	649	285
Dec	1222	800	422	98	140	699	285	NA	1291	732	559	98	146	741	306

NEW HOUSING ACTIVITY ANNUALLY, 1967-81
(In Thousands of Units)

						New Starts Under Government Programs							
	Total Private & Public Housing	Private Housing Starts			Mobile Home	FHA All Programs					Private Building Permits Issued		
Year	Starts	Total	Single Family	Multi-Family	Ship-ments	Single Family	Multi-Family	VA Total	FmHA Subsi-dized	HUD Public Housing	Total	Single Family	Multi-Family
1967	1321.9	1291.6	843.9	447.7	240.4	141.9	37.8	52.5	23.5	32.5	1141.0	650.6	490.5
1968	1545.4	1507.6	899.4	608.2	318.0	147.8	79.4	56.1	25.2	88.4	1353.4	894.7	658.7
1969	1499.5	1466.8	810.6	656.2	412.7	153.6	79.7	52.2	30.4	87.0	1323.7	625.9	697.9
1970	1469.0	1433.6	812.9	620.7	401.2	233.5	182.0	81.0	57.1	95.4	1351.5	646.8	704.8
1971	2084.5	2052.2	1151.0	901.2	496.6	300.9	224.8	94.3	74.7	68.5	1952.4	928.0	1024.5
1972	2378.5	2356.6	1309.2	1047.5	575.9	196.5	172.4	104.0	91.4	40.0	2218.9	1033.1	1185.8
1973	2057.5	2045.3	1132.0	913.3	566.9	73.4	88.6	96.1	63.3	26.7	1819.5	882.1	937.5
1974	1352.5	1337.7	888.1	449.7	329.3	56.7	37.7	72.9	41.2	16.7	1074.4	643.8	430.5
1975	1171.3	1160.4	892.2	268.3	212.7	69.7	26.0	77.0	48.6	15.2	939.2	675.5	263.9
1976	1547.6	1537.5	1162.4	375.1	246.1	81.0	64.7	99.9	63.8	28.0	1296.2	893.6	402.6
1977	2001.7	1987.1	1450.9	536.1	277.0	99.5	75.1	130.7	88.5	96.5	1690.0	1126.1	564.0
1978	2036.1	2009.3	1433.3	587.0	275.9	94.5	84.2	126.6	88.0	144.8	1800.5	1182.6	617.9
1979	1760.0	1745.1	1194.1	551.0	277.4	106.5	73.5	122.1	74.7	153.6	1551.8	981.5	570.3
1980	1312.6	1292.2	852.2	440.0	221.6	99.5	78.8	94.7	70.1	125.9	1190.6	710.4	480.2
1981	1100.3	1084.2	705.4	378.8	240.7	71.4	53.6	74.7	64.9	77.4	985.5	564.3	421.2
1982	1070.4	1060.6	661.0	399.6	NA	61.5	20.7	73.2	64.9	94.7	992.5	540.0	452.5

NA - Not Available

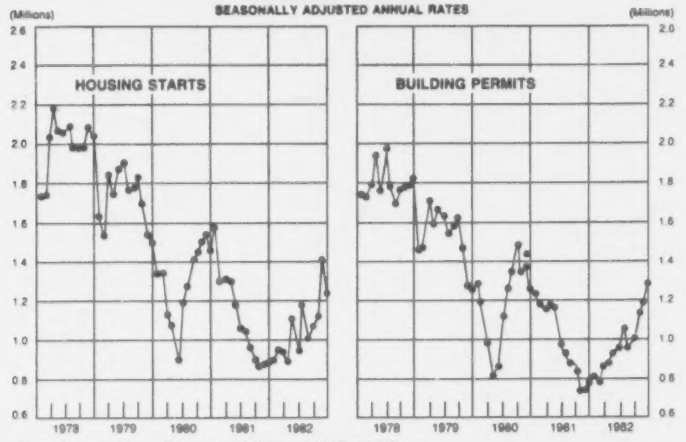
NOTE: FHA single family starts include rehabilitated units. FHA project starts excluded rehabilitated units after 1967; public housing as defined by the U.S. Department of Housing and Urban Development includes conventional, public, leased, and turnkey housing and effective January 1971, units are shown by month reported rather than actual month started, effective January 1977 Section 8 units are included.

SOURCE: *New Starts Under Government Programs*: U.S. Department of Housing and Urban Development, Farmers Home Administration, U.S. Department of Agriculture. All other starts (including public housing starts in columns entitled, *Total Public and Private Housing Starts*), mobile home shipments and private building permits issued Bureau of the Census, U.S. Department of Commerce, *Construction Reports, Housing Starts*, series C20; data compilation by NAHB Economics Division.

Table 2

HOUSING TRENDS

SEASONALLY ADJUSTED ANNUAL RATES



SOURCE: Bureau of the Census, U.S. Department of Commerce; NAHB Economics Division

HOUSING INDICES
(Units in Thousands)

Date	(1) Units Under Construction End of Period* One Unit	(2) Units Under Construction End of Period* 2 Units or more	(3) Housing Completions One Unit	(4) Housing Completions 2 Units or more	(5) New 1-Family Homes For Sale—end of period Sold	(6) New 1-Family Homes For Sale—end of period	(7) Vacancy Rates** For Sale	(8) Vacancy Rates** For Rent	(9) Med. Sales Price New 1-Family Homes Sold Census C25 all Homes	(10) Med. Sales Price New 1-Family Homes Sold FHA 203b**	(11) Census C-27** Price Index	(12) FHA 203b Sales Price per sq. ft.**	(13) Mort. Int. Rates New Homes Sold FHLBB
1977	730	479	1258	399	819	408	1.2	5.2	48,800	36,063	100.0	27.00	9.01
1978	765	546	1366	499	817	419	1.0	5.0	55,700	40,804	114.5	29.76	9.54
1979	639	501	1300	570	709	402	1.1	5.3	62,900	48,819	130.8	35.01	10.76
1980	515	383	957	545	545	342	1.4	5.4	64,600	54,524	145.2	40.46	12.65
1981	382	300	818	447	436	278	1.4	5.1	68,900	59,000	157.4	42.96	14.74
			Seasonally Adjusted Rates at annual rates			Seasonally Adjusted Rates monthly							
1982													
Feb	400	288	545	375	376	274	—	—	65,700	—	—	—	15.12
March	399	283	585	341	380	269	1.4	5.3	67,200	61,927	162.4	45.07	15.67
April	393	280	596	366	335	264	—	—	70,200	—	—	—	15.84
May	382	282	684	454	395	259	—	—	69,300	—	—	—	15.89
June	384	276	582	357	369	254	1.6	5.1	69,300	59,776	163.8	46.89	15.40
July	377	296	693	314	352	250	—	—	70,900	—	—	—	15.70
Aug	373	297	638	364	379	248	—	—	70,100	—	—	—	15.68
Sept	379	308	585	344	479	248	1.5	5.3	67,800	61,580	161.7	45.93	14.98
Oct	383	306	679	434	508	245	—	—	69,300	—	—	—	14.41
Nov	397	318	673	376	569	243	—	—	74,200	—	—	—	13.81

*Annual data denote units under construction last month in year

**Data available by quarter and year only

NA—Not Available

Source: (cols. 1-4) Census Bureau, U.S. Dept. of Commerce, *Housing Completions*, series C22. (cols. 5-8) Census Bureau, U.S. Dept. of Commerce, *New One-Family Homes Sold and For Sale*, series C25. (cols. 7-8) Census Bureau, U.S. Dept. of Commerce, *Housing Vacancies*, series H-111, (col. 9) same as cols. 5-8, (col. 10) Housing Characteristics Branch, Management Information Systems Division, Housing Production and Mortgage Credit-FHA, U.S. Department of Housing and Urban Development, *FHA Trends of Home Mortgage Characteristics*, series RR 250,(col. 11) Census Bureau, U.S. Dept. of Commerce, *Price Index of New One-Family Homes Sold*, series C27, (col. 12) same as col. 10, (col. 13) Federal Home Loan Bank Board, monthly news release, *Average Effective Interest Rates*.

TABLE 3

NUMBER OF UNEMPLOYED AMONG ALL WORKERS AND CONSTRUCTION WORKERS, 1971-1983
(Seasonally Adjusted Annual Rates in Thousands)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual
1971													
All Workers	4,986	4,903	4,987	4,959	4,996	4,949	5,035	5,134	5,042	4,954	5,161	5,154	5,016
Const. Workers	457	436	443	402	398	429	395	404	379	411	433	472	428
1972													
All Workers	5,019	4,928	5,038	4,959	4,922	4,923	4,913	4,539	4,849	4,875	4,602	4,543	4,882
Const. Workers	440	462	454	461	478	419	448	497	385	445	447	429	450
1973													
All Workers	4,326	4,452	4,394	4,459	4,329	4,363	4,305	4,305	4,350	4,144	4,396	4,489	4,365
Const. Workers	420	416	401	414	403	377	429	384	412	411	413	386	407
1974													
All Workers	4,644	4,731	4,634	4,618	4,705	4,927	5,063	5,022	5,437	5,523	6,140	6,636	5,156
Const. Workers	452	397	400	458	436	447	445	487	528	565	615	689	486
1975													
All Workers	7,501	7,520	7,978	8,210	8,433	8,220	8,127	7,928	7,923	7,897	7,794	7,744	7,929
Const. Workers	691	718	787	850	969	893	879	871	844	813	779	750	807
1976													
All Workers	7,534	7,326	7,230	7,330	7,053	7,053	7,322	7,490	7,518	7,380	7,430	7,620	7,406
Const. Workers	681	681	694	683	646	729	755	764	712	668	685	663	694
1977													
All Workers	7,280	7,443	7,307	7,059	6,911	7,134	6,829	6,925	6,751	6,763	6,815	6,386	6,991
Const. Workers	675	674	645	581	630	598	567	535	477	551	546	513	593
1978													
All Workers	6,489	6,318	6,337	6,180	6,127	6,028	6,309	6,080	6,125	5,947	6,077	6,228	6,202
Const. Workers	556	533	535	492	481	481	496	469	562	567	540	623	530
1979													
All Workers	6,112	6,173	6,104	6,062	5,861	5,950	5,986	6,313	6,183	6,298	6,248	6,361	6,137
Const. Workers	565	595	533	536	495	501	508	481	479	536	570	610	541
1980													
All Workers	6,674	6,674	6,717	7,348	7,970	8,063	8,353	8,287	8,044	8,111	8,029	7,796	7,637
Const. Workers	629	604	701	755	875	813	813	870	801	731	761	707	740
1981													
All Workers	8,048	8,032	7,967	7,860	8,133	8,047	7,854	8,053	8,271	8,673	9,025	9,389	8,273
Const. Workers	710	716	767	752	828	844	796	856	831	891	907	928	809
1982													
All Workers	9,346	9,669	9,881	10,256	10,384	10,466	10,828	10,931	11,315	11,576	11,906	12,036	10,678
Const. Workers	946	943	941	1,002	992	987	1,048	1,045	1,142	1,176	1,147	1,159	1,031
1983													
All Workers	11,446												
Const. Workers	1,043												

	Dec 82/ Jan 83	Jan 82/ Jan 83
All Workers	- 4.9%	22.5%
Constr Workers	-10.0	10.3

Source: Bureau of Labor Statistics, Compilation by NAHB Economics Division.

TABLE 3 (Cont).

UNEMPLOYMENT RATES: ALL WORKERS AND CONSTRUCTION WORKERS, 1971-1983
(Seasonally Adjusted Annual Rates)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual
1971													
All Workers	5.9%	5.9%	6.0%	5.9%	5.9%	5.9%	6.0%	6.1%	6.0%	5.8%	6.0%	6.0%	5.9%
Const. Workers	11.5	11.1	11.1	10.1	9.9	10.5	9.5	9.6	9.4	9.8	10.3	10.9	10.4
1972													
All Workers	5.8%	5.7%	5.8%	5.7%	5.7%	5.7%	5.6%	5.6%	5.5%	5.6%	5.3%	5.2%	5.6%
Const. Workers	10.3	10.8	10.3	10.5	10.9	9.7	10.4	11.3	8.9	10.1	10.1	9.7	10.3
1973													
All Workers	4.9%	5.0%	4.9%	5.0%	4.9%	4.9%	4.8%	4.8%	4.8%	4.6%	4.8%	4.9%	4.9%
Const. Workers	9.4	9.3	8.9	9.1	8.8	8.0	9.1	8.4	9.0	8.9	9.0	8.6	8.9
1974													
All Workers	5.1%	5.2%	5.1%	5.1%	5.1%	5.4%	5.5%	5.5%	5.9%	6.0%	6.6%	7.2%	5.6%
Const. Workers	9.5	8.5	8.6	9.9	9.5	9.9	10.2	10.9	11.6	12.1	13.6	15.3	10.7
1975													
All Workers	8.1%	8.1%	8.6%	8.8%	9.0%	8.8%	8.6%	8.4%	8.4%	8.4%	8.3%	8.2%	8.5%
Const. Workers	15.7	16.3	17.8	19.2	21.5	19.8	19.5	19.1	18.5	17.8	17.4	16.8	18.0
1976													
All Workers	7.7%	7.6%	7.7%	7.4%	7.6%	7.6%	7.8%	7.8%	7.6%	7.7%	7.8%	7.8%	7.7%
Const. Workers	15.5	15.4	15.7	15.6	14.7	16.3	16.8	16.6	15.7	14.7	15.4	14.3	15.5
1977													
All Workers	7.5%	7.6%	7.4%	7.2%	7.0%	7.2%	6.9%	7.0%	6.8%	6.8%	6.8%	6.4%	7.0%
Const. Workers	14.8	14.7	13.9	12.5	13.4	12.6	12.0	11.5	10.5	11.8	11.4	10.8	12.7
1978													
All Workers	6.4%	6.3%	6.3%	6.1%	6.0%	5.9%	6.2%	5.9%	6.0%	5.8%	5.9%	6.0%	6.0%
Const. Workers	11.6	11.1	11.0	9.8	9.7	9.6	9.8	9.2	10.9	11.2	10.8	12.2	10.6
1979													
All Workers	5.9%	5.9%	5.8%	5.8%	5.6%	5.7%	5.7%	6.0%	5.9%	6.0%	5.9%	6.0%	5.8%
Const. Workers	10.9	11.5	10.2	10.4	9.6	9.6	9.7	9.2	9.1	10.0	10.5	11.2	10.3
1980													
All Workers	6.3%	6.3%	6.3%	6.9%	7.5%	7.5%	7.8%	7.7%	7.5%	7.5%	7.5%	7.3%	7.1%
Const. Workers	11.6	11.3	13.2	14.6	16.2	15.4	15.8	16.7	15.5	14.0	14.5	13.7	14.1
1981													
All Workers	7.5%	7.4%	7.3%	7.2%	7.5%	7.4%	7.2%	7.4%	7.6%	8.0%	8.3%	8.6%	7.6%
Const. Workers	13.6	13.8	14.9	14.4	15.8	16.3	15.2	16.2	15.9	17.2	17.7	18.0	15.6
1982													
All Workers	8.6%	8.8%	9.0%	9.3%	9.4%	9.5%	9.8%	9.9%	10.2%	10.5%	10.7%	10.8%	9.7%
Const. Workers	18.5	18.3	18.2	19.3	18.9	19.5	20.3	20.4	22.0	22.3	21.8	22.0	20.0
1983													
All Workers	10.4%												
All Workers (incl. Military)	10.2												
Const. Workers	20.0												

[illegible] Statistics; compilation by NAHB Economics Division.

TABLE 4

CONTRACT INTEREST RATE

1963	5.63%	1973	7.76%
1964	5.62%	1974	8.72%
1965	5.60%	1975	8.75%
1966	6.04%	1976	8.73%
1967	6.25%	1977	8.75%
1968	6.76%	1978	9.28%
1969	7.61%	1979	10.43%
1970	8.35%	1980	12.29%
1971	7.42%	1981	14.17%
1972	7.35%	1982	14.47%

TABLE 5

FEDERALLY SUBSIDIZED HOUSING STARTS
1982-1983

Program	1982	1983
FHA Multifamily	21,000	26,000
Section 8 and Public Housing	95,000	2,200
Section 235	10,700	500
Farmers Homes	65,000	65,000
	191,700	93,700

TABLE 6

NAHB ECONOMETRIC FORECASTS
HOUSING STARTS BY CENSUS REGION, SAAR (IN THOUSANDS)

01/14/83	ANNUAL DATA 1980	1981	1982	1983	1981 I	II	III	IV	1982 I	II	III	IV	1983 I	II	III	IV
UNITED STATES TOTAL	1292.2	1084.1	1087.8	1375.0	1442.0	1159.1	959.0	867.1	964.4	937.6	1040.3	1306.0	1322.7	1333.9	1385.4	1444.9
Y/Y % CHANGE	-25.9	-16.1	0.3	26.4	11.5	11.4	-30.4	-41.8	-33.1	-19.1	13.7	50.6	37.1	42.3	27.1	10.9
SINGLE FAMILY	852.1	705.3	661.3	843.0	863.0	777.2	647.0	552.7	588.8	602.4	650.8	770.7	828.4	814.9	865.8	880.7
Y/Y % CHANGE	-28.6	-17.2	-6.2	27.5	13.0	13.1	-32.2	-44.9	-31.8	-22.5	0.6	39.5	40.7	35.4	29.8	14.3
MULTIFAMILY	440.1	378.8	426.5	532.0	579.0	381.9	312.0	314.4	375.6	335.2	439.4	535.3	494.3	519.0	540.4	564.1
Y/Y % CHANGE	-20.1	-13.9	12.6	24.8	9.4	8.2	-26.4	-35.4	-35.1	-12.2	40.8	70.2	31.6	53.6	23.0	8.1
2-4 FAMILY	109.6	91.2	89.2	106.1	171.2	83.6	74.2	68.5	109.8	85.2	85.7	105.8	104.4	103.6	107.4	108.1
Y/Y % CHANGE	-10.2	-16.8	-2.1	18.9	4.7	9.9	-36.2	-34.1	-35.9	-22.1	15.5	54.5	-5.0	59.0	25.3	2.2
5+ FAMILY	330.5	287.6	337.2	425.9	407.8	298.2	237.8	245.9	265.8	270.0	353.7	429.4	390.0	411.3	433.1	459.9
Y/Y % CHANGE	-22.9	-13.0	17.3	26.3	11.5	7.7	-22.7	-25.8	-34.8	-9.4	48.8	74.6	46.7	52.3	22.4	7.1
MOBILE HOMES	233.8	229.1	243.3	289.4	237.1	214.6	215.8	207.3	202.7	246.8	241.2	241.7	256.9	291.5	299.7	303.5
Y/Y % CHANGE	-16.2	-2.0	6.2	19.0	-11.8	8.1	9.4	-14.5	-14.5	15.0	11.7	16.6	25.8	18.1	24.3	25.5
NORTHEAST TOTAL	126.8	116.7	120.4	134.6	135.6	118.1	121.3	101.1	107.8	118.0	118.8	135.1	133.8	129.2	131.0	143.2
Y/Y % CHANGE	-29.2	-7.4	3.1	11.7	6.4	-7.7	-9.3	-13.8	-20.5	-0.9	-2.7	33.6	24.2	17.4	11.0	6.0
SINGLE FAMILY	87.0	84.2	78.0	85.2	108.4	86.9	80.1	69.7	71.9	76.1	74.7	84.6	88.2	81.2	82.0	91.8
Y/Y % CHANGE	-28.7	-3.2	-7.4	9.2	31.2	4.5	-13.5	-18.8	-33.6	-12.4	-6.8	21.4	22.6	6.7	9.8	8.5
MULTIFAMILY	39.0	32.5	42.4	49.4	27.2	31.2	41.1	31.4	35.8	33.9	43.3	50.4	45.7	48.0	48.9	51.4
Y/Y % CHANGE	-30.4	-16.6	30.4	16.5	-39.4	-30.4	0.1	-0.1	31.9	8.6	5.2	60.8	27.5	41.5	13.1	1.9
2-4 FAMILY	8.8	7.6	6.7	13.8	9.5	7.3	10.7	8.4	6.3	5.9	3.5	11.9	13.1	12.8	13.1	12.7
Y/Y % CHANGE	-27.3	-4.4	-12.2	92.9	-0.8	2.0	49.7	-1.7	-34.1	-18.9	-67.3	41.2	108.8	116.7	275.6	6.8
5+ FAMILY	31.0	24.9	35.7	36.5	17.6	23.9	30.5	22.9	29.6	28.0	39.8	38.5	32.6	35.2	35.8	38.7
Y/Y % CHANGE	-31.1	-19.8	43.5	2.1	-50.0	-36.6	-10.3	0.5	67.6	16.9	30.7	68.1	10.2	25.6	-9.9	0.4
NORTH CENTRAL TOTAL	219.0	165.2	161.8	219.3	258.8	184.6	143.0	132.7	186.1	153.9	165.4	218.6	204.2	209.1	220.7	235.1
Y/Y % CHANGE	-37.4	-24.6	-2.1	35.5	22.0	10.7	-38.1	-50.1	-58.9	-16.6	1.7	58.6	92.5	35.9	51.8	11.7
SINGLE FAMILY	142.0	110.2	101.7	132.8	171.1	123.9	97.5	81.0	77.4	104.1	92.0	121.6	123.0	121.8	131.3	148.7
Y/Y % CHANGE	-41.6	-22.4	-7.7	30.5	48.3	12.8	-37.8	-53.7	-54.5	-15.9	-5.7	50.2	57.8	18.9	42.7	22.3
MULTIFAMILY	77.0	55.0	60.1	86.5	86.9	60.7	45.5	51.8	28.1	49.4	53.4	89.8	81.2	85.3	89.4	86.4
Y/Y % CHANGE	-28.9	-28.6	9.3	44.1	-9.6	6.6	-38.6	-43.0	-67.6	-18.0	17.5	71.8	188.5	71.4	67.3	-2.9
2-4 FAMILY	21.0	16.2	14.5	20.5	30.1	15.2	13.1	16.7	10.1	12.2	9.7	22.1	21.6	20.7	20.5	19.5
Y/Y % CHANGE	-22.2	-22.8	-10.7	41.5	103.8	-20.2	-33.9	-37.8	-66.6	-19.8	-26.2	32.1	115.0	69.2	112.5	-11.5
5+ FAMILY	56.0	38.8	45.6	66.1	56.7	45.5	32.4	35.1	18.1	37.5	43.8	66.9	59.6	64.6	68.8	66.8
Y/Y % CHANGE	-38.0	-30.8	17.6	44.9	-36.2	20.1	-40.6	-45.1	-68.1	-17.5	35.1	90.8	229.4	72.1	57.3	-0.1

table 6(Cont). NAHB ECONOMETRIC FORECASTS
HOUSING STARTS BY CENSUS REGION, SAAR (IN THOUSANDS)

	ANNUAL DATA				1981				1982				1983			
01/16/83	1980	1981	1982	1983	I	II	III	IV	I	II	III	IV	I	II	III	IV
SOUTH																
TOTAL	663.0	560.2	587.6	697.1	742.7	616.1	482.7	431.4	563.2	495.9	624.3	658.5	665.8	680.8	699.8	742.7
Y/Y % CHANGE	-14.9	-12.9	4.9	18.6	21.8	14.2	-29.1	-41.5	-24.2	-19.5	29.3	52.7	18.2	37.3	12.1	12.8
SINGLE FAMILY	428.8	383.6	352.8	433.3	464.5	407.3	321.7	270.8	321.9	318.7	381.3	393.9	423.6	426.4	431.4	451.6
Y/Y % CHANGE	-18.9	-15.0	-3.9	22.8	13.2	14.2	-32.8	-43.3	-30.7	-21.7	18.3	45.9	31.6	33.8	19.4	15.2
MULTIFAMILY	215.0	196.6	234.7	263.8	278.3	208.8	161.1	161.4	241.4	177.1	243.0	264.6	242.2	254.4	268.3	289.1
Y/Y % CHANGE	-8.9	-8.5	19.4	12.4	39.4	14.2	-22.4	-39.2	-13.3	-15.2	83.3	64.0	0.3	43.6	2.0	9.3
2-4 FAMILY	69.0	66.2	66.5	67.2	60.8	68.4	60.3	38.2	67.1	33.0	50.4	65.1	62.9	66.6	67.9	72.1
Y/Y % CHANGE	19.5	-9.7	5.1	1.5	33.7	30.5	-21.2	-38.0	10.4	-31.9	25.2	17.9	-30.0	35.4	-4.9	15.6
5+ FAMILY	166.0	152.4	188.3	216.6	217.5	160.4	120.8	123.1	174.3	144.1	212.6	219.5	199.3	209.8	220.4	237.9
Y/Y % CHANGE	-10.3	-8.2	23.5	15.1	41.1	10.0	-22.8	-39.6	-19.9	-10.1	76.0	78.3	14.3	45.5	3.7	8.0
WEST																
TOTAL	300.0	239.2	218.0	324.0	296.1	270.4	212.6	185.5	187.4	177.9	282.5	301.8	318.8	314.8	334.8	327.8
Y/Y % CHANGE	-34.8	-21.8	-8.9	48.6	-11.0	13.2	-36.2	-44.1	-36.7	-34.2	-4.7	62.7	70.1	76.9	64.9	8.6
SINGLE FAMILY	196.8	148.2	128.7	191.7	188.3	169.3	132.3	100.6	117.1	103.4	122.8	178.6	193.6	187.5	200.3	186.5
Y/Y % CHANGE	-35.9	-24.6	-13.2	48.9	-8.8	15.9	-40.6	-56.0	-37.8	-38.9	-7.2	59.6	65.3	81.2	63.1	9.4
MULTIFAMILY	110.8	98.9	89.3	132.3	107.9	101.2	80.2	84.9	70.3	74.4	79.7	131.3	125.2	127.3	133.8	141.2
Y/Y % CHANGE	-32.5	-17.3	-1.8	48.2	-14.4	8.9	-27.9	-24.8	-34.9	-26.4	-0.6	54.6	78.2	71.8	67.8	7.6
2-4 FAMILY	30.8	21.3	21.6	25.5	29.7	24.5	18.9	20.2	26.4	14.1	22.1	26.8	26.7	25.5	25.8	23.8
Y/Y % CHANGE	-33.3	-29.8	1.3	18.2	-13.4	-12.2	-38.1	-28.2	-11.3	-42.5	17.3	32.7	1.2	81.1	16.4	-11.2
5+ FAMILY	80.0	69.6	67.7	106.8	78.2	76.7	61.4	64.7	43.9	60.4	57.6	104.5	98.5	101.8	108.0	117.4
Y/Y % CHANGE	-32.2	-12.9	-2.8	57.8	-14.9	17.9	-24.9	-23.7	-43.8	-21.3	-6.2	61.5	126.4	68.7	87.5	12.4

January 18, 1983

TABLE 7
FORECAST ASSUMPTIONS

NAME		1981 I	1981 II	1981 III	1981 IV	1982 I	1982 II	1982 III	1982 IV	1983 I	1983 II	1983 III	1983 IV
AAA Bond Yields	%	13.16	13.98	14.92	14.62	15.01	14.51	13.75	11.88	11.20	11.00	10.90	10.80
"T" Bill Yield	%	14.37	14.83	15.09	12.02	12.90	12.36	9.71	7.94	7.60	7.20	7.00	7.00
FHLBB Advances (in millions of $)		+211	+6919	+8252	+848	+968	+3236	-1756	-1632	-3300	-1400	-600	-1800
FNMA Purchases (in millions of $--excluding GNMA purchases)		+431	+736	+2695	+2249	+1552	+2984	+3750	+4800	+4100	+3900	+4000	+4200
Consumer Price Index		263.1	269.1	276.7	280.4	282.5	286.8	292.3	296.7	299.6	303.8	307.9	312.2
% Change		2.61	2.28	2.82	1.34	0.75	1.52	1.92	1.51	0.96	1.43	1.35	1.39
% Change Annual Rate		10.87	9.44	11.78	5.46	3.03	6.23	7.89	6.17	3.90	5.85	5.49	5.69
Prime Rate	%	19.21	18.93	20.32	17.01	16.27	16.50	14.72	11.96	10.50	9.50	9.20	9.00
Personal Income (billions of $)		2330.0	2380.6	2458.2	2494.6	2510.5	2552.7	2592.5	2623.2	2663.1	2711.0	2760.6	2816.1
% Change		3.10	2.17	3.26	1.48	0.64	1.68	1.56	1.18	1.52	1.80	1.83	2.01
% Change Annual Rate		12.98	8.47	13.69	6.06	2.57	6.90	6.38	4.82	6.22	7.40	7.52	8.31
Personal Savings (billions of $)		105.4	122.0	134.4	158.6	139.1	144.3	152.0	128.9	135.8	143.7	157.4	154.1
Savings as % of Personal Income		4.5	5.1	5.5	6.4	5.5	5.7	5.9	4.9	5.1	5.3	5.7	5.5
Unemployment Rate	%	7.4	7.4	7.4	8.3	8.8	9.4	10.0	10.7	10.6	10.4	10.0	9.8
Subsidized Units	Section 8	11,548	10,935	23,346	3,639	5,277	17,921	44,357	6,469	1,600	400	200	-0-
	Section 235	8,566	8,359	5,634	3,229	2,120	3,353	3,284	3,416	300	100	50	-0-
	Total Units	20,114	19,294	29,980	6,868	7,397	21,274	47,641	9,885	1,900	500	250	-0-

Comparison of Reagan Budget with CBO Projections - February 1983

	1983	1984	1985	1986	1987	1988
Federal Outlays*						
Reagan Budget	$803.2	$848.5	$918.5	$ 989.6	$1,058.4	$1,126.9
CBO Baseline	800.0	850.0	920.0	999.0	1,072.0	1,145.0
CBO High Growth	792.0	830.0	904.0	971.0	1,041.0	1,116.0
CBO Low Growth	804.0	868.0	958.0	1,032.0	1,110.0	1,187.0
Federal Receipts*						
Reagan Budget	$597.5	$639.7	$724.3	$ 841.9	$ 967.9	$1,070.3
CBO Baseline	606.0	653.0	715.0	768.0	882.0	878.0
CBO High Growth	615.0	676.0	743.0	798.0	862.0	933.0
CBO Low Growth	599.0	637.0	686.0	730.0	777.0	825.0
Federal Deficit*						
Reagan Budget	$207.7	$188.8	$194.2	$ 147.7	$ 142.1	$ 116.7
CBO Baseline	194.0	197.0	214.0	231.0	250.0	267.0
CBO High Growth	177.0	155.0	162.0	172.0	179.0	183.0
CBO Low Growth	205.0	232.0	272.0	302.0	333.0	363.0
Nominal GNP **						
Reagan Budget	8.8%	9.2%	9.0%	8.7%	8.7%	8.6%
CBO Baseline	6.8	9.6	9.0	8.1	7.6	7.4
CBO High Growth	9.0	11.3	9.5	9.1	8.9	9.1
CBO Low Growth	5.4	7.9	7.9	7.2	6.6	6.4
Real GNP **						
Reagan Budget	3.1%	4.0%	4.0%	4.0%	4.0%	4.0%
CBO Baseline	2.1	4.7	4.1	3.7	3.5	3.5
CBO High Growth	4.0	6.0	4.2	4.0	4.0	4.0
CBO Low Growth	0.8	3.3	3.3	3.2	3.0	3.0
GNP Deflator **						
Reagan Budget	5.6%	5.0%	4.8%	4.5%	4.5%	4.4%
CBO Baseline	4.6	4.7	4.7	4.3	3.9	3.8
CBO High Growth	4.8	4.9	5.1	4.9	4.8	4.9
CBO Low Growth	4.5	4.4	4.4	3.9	3.5	3.2
CPI/Urban Workers **						
Reagan Budget	5.0%	4.4%	4.7%	4.5%	4.5%	4.4%
CBO Baseline	4.5	5.0	4.7	4.1	3.9	3.7
CBO High Growth	4.6	5.3	5.0	4.6	4.6	4.8
CBO Low Growth	4.5	4.9	4.4	3.8	3.4	3.2
91-Day "T" Bill Rate						
Reagan Budget	8.0%	7.9%	7.4%	6.8%	6.5%	6.1%
CBO Baseline	6.8	7.4	7.2	6.6	6.1	5.9
CBO High Growth	4.4	5.4	5.7	5.0	5.0	4.9
CBO Low Growth	8.4	9.9	8.9	7.7	7.2	6.3
Unemployment Rate						
Reagan Budget***	10.3%	10.3%	9.5%	7.8%	7.0%	6.2%
CBO Baseline	10.6	10.6	9.8	8.4	8.0	7.5
CBO High Growth	9.9	9.9	8.5	7.0	6.4	6.0
CBO Low Growth	11.2	11.2	10.9	9.8	9.4	9.0

* In billions of dollars

** Percent Change

*** Fourth quarter rates

NOTE: The budget outlays, receipts, and deficits are by fiscal year. The economic assumptions are by calendar year.

Source: Office of Management and Budget. Congressional Budget Office.

TABLE 9

BUDGET AUTHORITY BY FUNCTIONS, 1980, 1982-1986
(in billions of dollars)

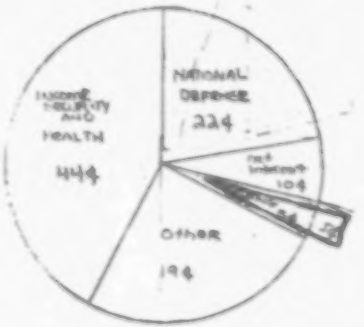
Function	1980	1982	1983	1984	1985	1986
National Defense	$145.8	$218.7	$245.4	$280.5	$330.0	$ 364.8
International Affairs	15.5	15.3	17.1	16.8	16.3	15.8
General Science, Space and Technology	6.1	7.0	7.9	8.4	8.5	7.7
Energy	36.4	3.7	3.7	2.9	3.1	3.1
Natural Resources and Environment	13.1	11.2	11.2	8.9	8.9	8.7
Agriculture	5.0	18.7	18.2	13.5	9.8	8.3
Commerce and Housing Credit	10.5	6.4	4.9	7.6	5.6	4.5
Mortgage Credit/Thrift Insurance	[6.5]	[4.0]	[2.4]	[5.7]	[3.8]	[2.7]
Transportation	20.2	21.3	26.7	27.8	28.5	29.4
Community and Regional Development	10.1	6.6	6.6	6.6	6.8	6.8
Education, Training, Employment and Social Services	30.6	25.9	26.0	25.6	24.8	25.0
Health	59.8	78.9	67.6	91.7	100.6	112.3
Income Security	224.2	254.2	301.3	284.2	315.6	344.6
Housing Assistance	[27.8]	[13.9]	[5.7]	[0.4]	[0.6]	[4.7]
Veterans Benefits and Services	21.2	25.0	25.0	26.1	26.9	27.9
Administration of Justice	4.4	4.7	5.2	5.6	5.5	5.5
General Government	4.6	4.9	5.7	6.1	6.2	6.3
General Purpose Fiscal Assistance	8.7	6.4	6.3	7.0	6.9	7.1
Net Interest	64.5	84.7	88.9	103.2	114.2	122.7
Allowances	—	—	—	1.0	3.9	5.8
Undistributed Offsetting Receipts	-21.9	-13.3	-20.4	-22.8	-24.6	-26.4
Total	$658.8	$779.9	$847.3	$900.2	$997.5	$1,079.8

BUDGET AUTHORITY BY FUNCTIONS, 1980, 1982-1986
(percent share)

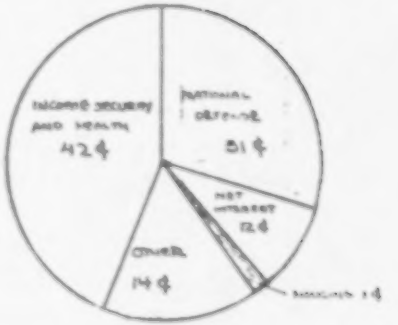
Function	1980	1982	1983	1984	1985	1986
National Defense	22.1%	28.0%	29.0%	31.2%	33.1%	33.8%
International Affairs	2.4	2.0	2.0	1.9	1.6	1.5
General Science, Space and Technology	0.9	0.9	0.9	0.9	9.9	0.7
Energy	5.5	0.5	0.4	0.3	0.3	0.3
Natural Resources and Environment	2.0	1.4	1.3	1.0	0.9	0.8
Agriculture	0.8	2.4	2.1	1.5	1.0	0.8
Commerce and Housing Credit	1.6	0.8	0.6	0.8	0.6	0.4
Mortgage Credit/Thrift Insurance	[1.0]	[0.5]	[0.3]	[0.6]	[0.3]	[0.2]
Transportation	3.1	2.7	3.2	3.1	2.9	2.7
Community and Regional Development	1.5	0.8	0.8	0.7	0.7	0.6
Education, Training, Employment and Social Services	4.6	3.3	3.1	2.8	2.5	2.3
Health	9.1	10.1	8.0	10.2	10.1	10.4
Income Security	34.0	32.6	35.6	31.6	31.6	31.9
Housing Assistance	[4.2]	[1.8]	[0.7]	[0.1]	[0.1]	[0.4]
Veterans Benefits and Services	3.2	3.2	2.9	2.9	2.7	2.6
Administration of Justice	0.7	0.6	0.6	0.6	0.5	0.5
General Government	0.7	0.6	0.7	0.7	0.6	0.6
General Purpose Fiscal Assistance	1.3	0.8	0.7	0.8	0.7	0.7
Net Interest	9.8	10.9	10.5	11.5	11.4	11.4
Allowances	—	—	—	0.1	0.4	0.5
Undistributed Offsetting Receipts	-3.3	-1.7	-2.4	-2.5	-2.5	-2.4
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

THE BUDGET DOLLAR: WHERE IT GOES

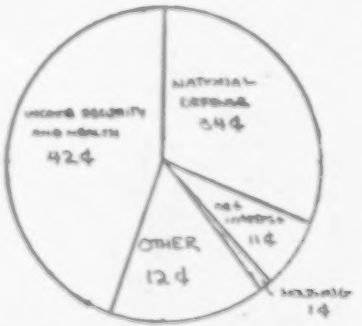
BUDGET AUTHORITY



FY 1980
(ACTUAL)



FY 1984
(PROJECTED)



FY 1986
(PROJECTED)

TABLE 19

CREDIT MARKET FUNDS RAISED, 1946-1982
(in billions of dollars)

DOLLAR VOLUME

Year	Total Credit Market Debt	U.S. Govt. Securities	State & Local Government Obligations	Corporate & Foreign Bonds	Mortgages Residential	Mortgages Other	Consumer Credit	Bank Loans N.E.C.	Open Market Paper	Other Loans
1946	$ -6.8	$-23.2	$ 0.1	$ 1.0	$ 4.8	$ 1.4	$ 2.7	$ 5.3	$ 0.3	$ 2.7
1950	27.0	-0.8	3.3	2.2	9.0	1.1	4.8	5.9	0.2	1.3
1955	41.4	0.2	5.3	3.6	13.4	2.8	7.2	7.3	-0.2	1.8
1960	39.6	-1.7	5.3	5.4	13.1	4.0	4.4	3.6	2.2	3.3
1965	80.4	3.9	7.1	8.1	20.7	6.7	10.6	15.8	0.9	6.4
1970	108.4	21.7	11.2	23.3	25.9	4.0	5.4	7.3	2.1	7.5
1971	154.5	30.9	17.4	24.7	39.8	12.7	14.7	11.0	-0.1	3.5
1972	191.3	23.6	14.7	20.3	56.5	20.3	19.8	26.1	1.6	8.4
1973	230.2	28.3	14.7	14.6	54.5	24.6	24.3	48.8	8.3	20.2
1974	227.7	31.9	16.5	24.9	42.8	20.3	9.9	41.3	17.7	22.5
1975	213.4	94.9	16.1	36.7	43.9	15.9	9.6	-12.2	-1.2	9.8
1976	285.4	83.8	15.7	41.2	69.5	17.6	25.4	6.2	8.1	17.8
1977	379.9	79.9	21.9	36.1	104.4	25.5	40.2	29.5	15.0	27.4
1978	477.4	90.5	28.4	31.8	122.1	28.9	48.8	59.0	26.4	41.5
1979	489.7	84.8	29.8	34.2	126.6	35.8	45.4	51.0	40.3	41.8
1980	463.5	122.9	35.9	41.1	104.6	29.4	4.9	46.5	21.6	36.6
1981	499.1	132.6	32.9	28.5	80.5	34.7	25.3	57.0	34.0	53.7
1982**	489.1	200.3	50.0	32.3	64.8	23.1	13.4	67.3	12.1	25.8

PERCENT DISTRIBUTION

Year	Total Credit Market Debt	U.S. Govt. Securities	State & Local Government Obligations	Corporate & Foreign Bonds	Mortgages Residential	Mortgages Other	Consumer Credit	Bank Loans N.E.C.	Open Market Paper	Other Loans
1946	100.0%	N/M	N/M	N/M	N/M	N/M	N/M	N/M	N/M	N/M
1950	100.0	2.9%	12.2%	8.1%	33.3%	4.1%	17.8%	21.9%	0.7%	4.8%
1955	100.0	0.5	12.8	8.7	32.4	6.7	17.4	17.6	-0.5	4.3
1960	100.0	-4.2	13.4	13.6	33.1	10.1	11.1	9.1	5.6	8.3
1965	100.0	4.9	9.1	10.1	25.8	8.3	13.2	19.6	1.1	7.9
1970	100.0	20.0	10.3	21.5	23.9	3.7	5.0	6.7	1.9	6.9
1971	100.0	20.0	11.3	16.0	25.8	8.2	9.5	7.1	*	2.2
1972	100.0	12.3	7.7	10.6	29.5	10.6	10.4	13.6	0.8	4.4
1973	100.0	11.9	6.2	6.1	22.9	10.3	10.2	20.5	3.5	8.5
1974	100.0	14.0	7.2	10.9	18.8	8.9	4.3	18.1	7.8	9.9
1975	100.0	44.5	7.5	17.2	20.6	7.5	4.5	-5.7	-0.6	4.6
1976	100.0	29.4	5.5	14.4	24.4	6.2	8.9	2.2	2.8	6.2
1977	100.0	21.0	5.8	9.5	27.5	6.7	10.6	7.8	3.9	7.2
1978	100.0	19.0	5.9	6.7	25.6	6.0	10.2	12.4	5.5	8.7
1979	100.0	17.3	6.1	7.0	25.9	7.3	9.3	10.4	8.2	8.5
1980	100.0	27.7	8.1	9.3	23.6	6.6	1.1	10.5	4.9	8.3
1981	100.0	26.6	6.6	5.7	16.1	6.9	5.1	11.4	10.8	10.8
1982**	100.0	41.0	10.2	6.6	13.2	4.7	2.7	13.8	2.5	5.3

N/M Not accurable
* Less than one-tenth of one percent
** 1982 data is comprised of the average of the 1st three quarters of 1982 at seasonal rates.
SOURCE: Board of Governors of the Federal Reserve System, Flow of Funds Accounts, various issues; compilation by NAHB Economics Division.

CHART 2

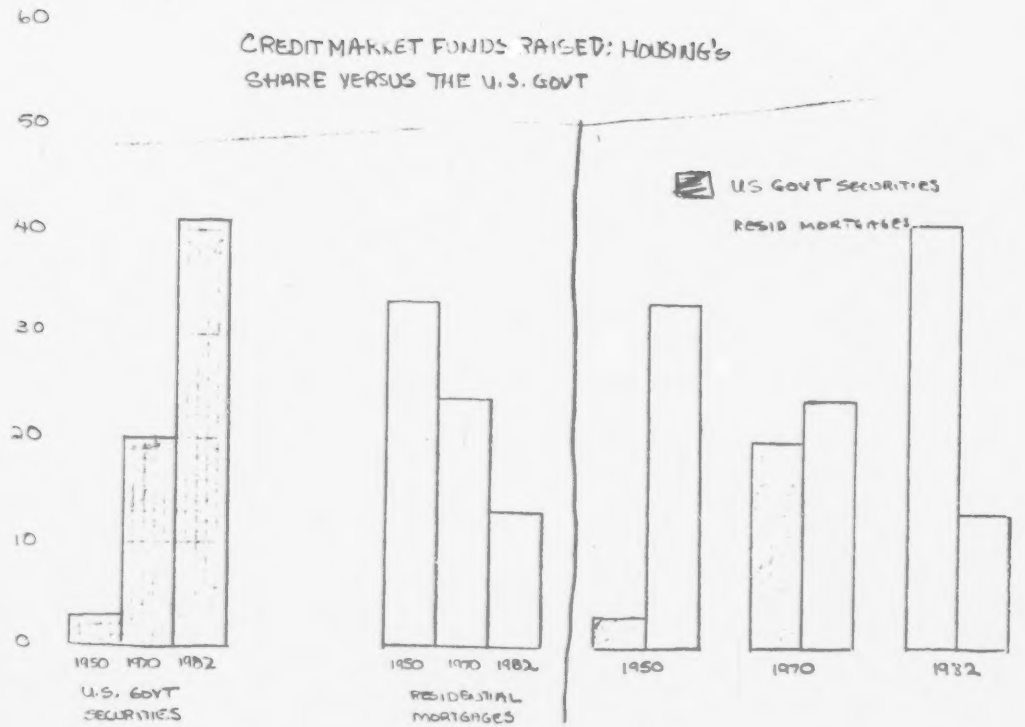

CREDIT MARKET FUNDS RAISED: HOUSING'S SHARE VERSUS THE U.S. GOVT
60
50
40
30
20
10
0
US GOVT SECURITIES
RESID MORTGAGES
1950
1970
1982
U.S. GOVT SECURITIES
RESIDENTIAL MORTGAGES

TABLE 10

BUDGET AUTHORITY FOR CONSTRUCTION AND HOUSING, 1980, 1982-1986
(in billions of dollars)

Function	1980	1982	1983	1984	1985	1986
Housing						
Subsidized Housing	NA	$ 12.2	$ 4.3	$ -2.3	$ -2.0	$ 3.0
Public Housing	NA	1.5	1.3	1.6	1.5	1.5
Indian Housing	NA	--	--	--	--	--
Rural Housing	NA	0.1	0.1	0.2	0.2	0.3
Sub Total	$ 27.8	$ 13.9	$ 5.7	$ 0.4	$ 0.6	$ 4.7
Mortgage Credit						
GNMA	$ 1.9	$ 1.1	$ --	$ 0.3	$ 0.3	$ 0.5
FHA	0.3	0.2	0.2	0.1	0.1	0.1
Elderly	0.8	0.7	0.6	0.4	0.5	0.6
Rural Housing	2.3	2.0	1.6	5.0	3.0	2.0
Sub Total	$ 6.5	$ 4.0	$ 2.4	$ 5.7	$ 3.8	$ 2.7
Total Housing	$ 34.3	$ 17.9	$ 8.1	$ 5.4	$ 4.4	$ 7.4
	Percent Share					
Housing	4.2%	1.8%	0.7%	0.1%	0.1%	0.4%
Mortgage Credit	1.0	0.5	0.3	0.6	0.3	0.2
Total Housing	5.2%	2.3%	1.0%	0.7%	0.4%	0.6%

CHART 3

DISTRIBUTION OF FEDERAL SECTOR EXPENDITURE
BY CATEGORY, FY 1950 - 1986

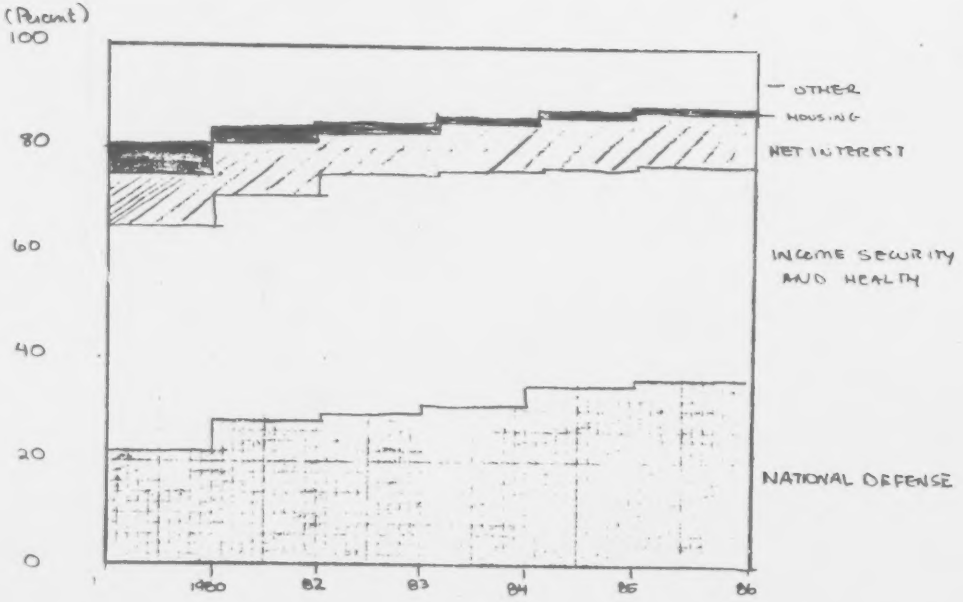
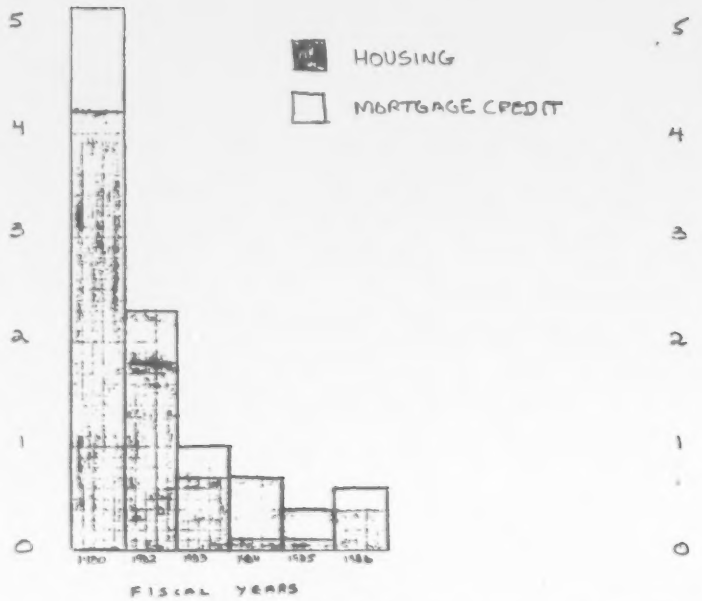


CHART 4

(Percent of Total)

BUDGET AUTHORITY FOR HOUSING AND CONSTRUCTION:
FISCAL YEARS 1980-1986



SOURCE: THE UNITED STATES BUDGET, VARIOUS ISSUES; COMPILED BY NAHB ECONOMIC AND POLICY ANALYSIS DIVISION

TABLE 12.

TOTAL MORTGAGE FUNDS ADVANCED
(in billions of dollars)

	1946	1950	1955	1960	1965	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1981 Q 1	1981 Q 2	1981 Q 3	1981 Q 4	1982 Q 1	1982 Q 2	1982 Q 3
I By Type of Mortgage																								
A. Total Dollar Volume	$ 8.2	$ 30.1	$ 36.2	$ 37.1	$ 27.4	$ 29.9	$ 52.5	$ 76.8	$ 79.1	$ 63.1	$ 58.8	$ 87.1	$125.9	$151.0	$162.4	$136.0	$115.2	$129.5	$139.0	$107.1	$ 85.3	$104.0	$ 80.2	$ 79.4
Home Mortgages	4.4	7.5	12.4	11.1	17.1	15.0	29.9	43.7	44.1	35.9	43.9	65.4	97.5	112.5	118.9	95.9	76.2	91.7	95.7	68.5	48.9	70.1	52.7	54.6
Multifamily Residential	0.6	1.5	0.9	2.1	1.6	4.9	9.9	12.8	10.4	4.9	*	3.9	7.0	9.2	7.7	8.7	4.3	4.2	5.2	4.0	3.9	4.1	3.8	3.1
Commercial	1.3	0.6	2.0	3.2	4.4	7.2	10.3	16.8	19.1	15.3	11.2	11.9	18.4	21.8	24.0	20.1	24.9	23.1	28.6	23.8	27.5	20.5	20.1	21.3
Farm	0.1	0.5	0.8	0.7	2.3	0.8	2.4	3.6	5.5	7.0	4.4	5.7	7.1	7.2	11.8	9.3	9.8	8.5	9.5	10.8	10.2	7.3	3.6	4.4
B. Percent Distribution	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Home Mortgages	71.0	74.3	77.8	64.9	62.4	50.2	57.0	56.9	55.8	56.9	73.5	75.3	73.0	74.8	73.2	71.4	66.1	70.8	68.8	64.0	57.3	67.4	65.7	68.9
Multifamily Residential	9.5	14.8	4.9	12.3	13.1	23.1	18.8	16.6	13.1	10.5	*	4.5	5.6	6.1	4.7	6.3	3.7	3.2	3.7	3.7	4.6	3.9	4.7	3.9
Commercial	21.0	5.9	12.3	18.7	16.1	24.1	19.6	21.9	24.1	24.2	18.7	13.7	14.2	14.4	14.8	17.0	21.6	18.4	20.6	22.2	24.1	19.7	25.1	18.9
Farm	1.6	5.0	4.9	4.1	8.4	2.7	4.6	4.6	7.0	7.9	7.7	6.5	5.4	4.8	7.3	4.9	8.5	6.6	6.8	10.1	12.0	7.0	4.5	8.3
II By Holder of Mortgage																								
A. Total Dollar Volume	$ 8.2	$ 30.1	$ 36.2	$ 37.1	$ 27.4	$ 29.9	$ 52.5	$ 76.8	$ 79.1	$ 63.1	$ 58.8	$ 87.1	$129.9	$151.0	$162.4	$136.0	$115.2	$129.5	$139.0	$107.1	$ 85.3	$104.0	$ 80.2	$ 79.4
Households	1.5	0.7	1.3	2.7	0.5	1.4	1.3	4.4	2.7	4.9	4.2	7.6	8.4	14.2	20.1	22.2	23.4	22.2	28.8	25.8	16.9	17.5	17.4	20.4
State/Local Govt. Gen. Funds	*	0.1	0.1	0.2	0.2	0.9	1.1	1.4	1.7	2.5	3.4	1.3	0.4	2.5	4.3	9.9	7.7	8.8	8.8	7.1	4.3	4.3	3.9	4.4
U.S. Government	-0.3	0.3	0.2	0.2	-0-	0.3	-0.4	-0.7	-0.4	3.8	6.5	0.4	4.2	4.2	4.4	7.3	6.9	5.1	5.7	2.9	4.1	1.5	4.5	4.2
Sponsored Credit Agencies	-0.1	*	0.3	1.1	1.1	5.3	3.6	6.0	7.2	10.2	5.3	2.9	3.5	12.2	14.4	14.1	12.6	6.6	11.9	18.1	13.9	7.9	15.9	20.1
Mortgage Pools	-0-	*	*	-0-	0.3	1.6	4.8	4.9	3.6	3.4	7.1	12.2	14.1	17.4	21.1	19.2	15.0	14.5	19.6	12.3	14.4	14.2	14.7	18.4
Private Financial Institutions	5.1	9.0	14.4	12.9	23.4	20.1	42.1	60.8	64.4	36.4	33.0	62.0	97.2	104.3	91.9	61.2	51.5	72.6	67.1	48.8	25.6	36.4	-0.3	-17.9
Commercial Banking	2.5	2.0	2.4	0.7	5.7	2.2	9.8	16.8	19.8	12.8	3.9	15.3	27.7	35.1	30.4	17.8	23.6	22.5	25.3	25.5	21.2	24.4	18.2	11.0
Savings Institutions	2.0	3.6	7.8	8.9	13.1	11.7	27.6	37.4	33.7	17.8	12.3	49.3	64.9	58.2	47.3	29.0	15.8	35.5	27.7	4.4	-4.3	4.3	-20.7	-39.5
S&L Associations	1.8	2.0	5.3	7.0	9.0	9.8	23.6	31.8	28.5	17.6	29.5	44.4	58.2	51.6	43.1	27.9	15.4	34.5	26.8	4.1	-3.7	3.7	-19.9	-37.8
Mutual Savings Banks	0.2	1.6	2.5	1.9	4.0	1.8	3.9	5.5	5.2	2.2	2.3	4.4	6.5	7.1	3.6	0.6	-0.1	0.5	0.3	-0.3	-1.1	-1.9	-4.3	-4.2
Credit Unions	*	-0-	*	0.1	0.1	0.1	*	0.2	0.4	0.1	0.5	0.5	0.3	0.6	0.6	0.5	0.5	0.6	0.6	0.5	0.5	0.5	0.5	0.5
Insurance	0.5	3.2	3.6	3.4	4.1	2.7	3.0	4.7	4.7	5.4	2.8	2.4	5.8	10.2	14.2	14.5	10.3	11.2	11.2	10.7	8.1	8.3	6.7	9.2
Life Insurance Companies	0.5	3.2	3.5	2.8	4.9	2.4	1.1	1.5	4.4	4.9	2.9	2.4	5.2	9.4	12.4	12.3	8.0	9.7	8.7	7.5	5.9	6.8	5.4	8.1
Private Pension Funds	*	*	0.1	0.3	0.6	-0-	-0.5	-0.9	-0.4	*	*	*	0.1	0.3	0.3	0.6	0.1	0.1	0.2	*	0.2	0.4	0.7	0.7
State/Local Gov. Ret. Funds	*	*	*	0.5	0.6	0.3	0.4	0.2	0.7	0.6	-0.2	0.2	0.5	0.5	1.0	1.3	1.8	1.2	1.9	2.8	1.5	2.6	0.3	2.0
Other Insurance Companies	*	*	*	-0-	-0-	-0-	*	*	*	*	0.1	0.1	0.1	*	0.3	0.3	0.4	0.2	0.4	0.4	0.4	0.4	0.4	0.4
Finance Companies	0.1	0.2	0.4	-0-	0.5	1.7	1.3	2.7	1.9	-1.9	-1.3	-0.4	1.2	0.9	0.8	0.6	2.9	3.7	4.2	1.7	2.1	2.9	-2.1	1.8
REITS	--	--	--	--	--	1.8	2.3	4.2	5.6	0.2	-4.8	-3.8	-2.4	-1.1	-1.0	-0.7	-1.1	-0.3	-1.3	-2.4	-1.4	-1.6	-0.5	-0.3
B. Percent Distribution	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Households	18.3	2.3	3.6	15.8	1.8	4.6	2.5	5.7	3.4	7.8	7.1	8.6	6.5	9.4	12.4	16.4	20.3	17.1	20.7	24.1	19.8	16.8	21.6	25.7
State/Local Govt. Gen. Funds	*	1.0	0.4	1.2	0.7	3.0	2.1	1.8	2.1	4.0	2.7	1.5	0.5	1.6	2.9	7.4	6.7	6.8	6.3	6.6	7.4	4.1	4.9	5.6
U.S. Government	-4.8	1.0	1.2	1.2	-0-	1.0	-0.8	-0.9	-0.8	6.0	10.9	0.5	3.2	2.8	4.3	5.8	4.3	3.9	4.1	2.7	7.1	1.4	6.1	5.3
Sponsored Credit Agencies	-1.4	*	1.0	4.4	4.0	17.8	6.9	7.8	9.1	16.2	8.7	3.3	2.7	8.1	8.9	10.3	10.9	4.9	8.6	16.9	16.3	7.6	19.8	25.3
Mortgage Pools	-0-	*	*	-0-	1.1	5.4	9.1	6.4	4.5	5.4	11.9	14.0	10.4	9.0	14.2	14.3	13.0	11.2	11.9	11.5	19.5	14.8	17.8	24.0
Private Financial Institutions	62.3	29.1	38.3	75.4	92.4	67.4	80.2	79.2	81.7	57.7	55.3	72.2	74.8	69.1	56.6	45.7	44.7	56.1	48.3	46.1	30.0	35.2	-0.4	-22.5
Commercial Banking	30.3	6.8	6.7	2.0	22.7	7.4	18.7	21.9	25.0	20.3	6.5	17.5	21.3	23.2	18.8	13.3	20.5	17.4	18.2	23.8	24.9	23.7	22.7	13.8
Savings Institutions	24.3	11.6	19.3	24.0	52.0	37.9	35.3	51.6	42.7	28.1	51.4	56.0	49.7	38.5	29.2	25.1	21.6	27.4	19.9	4.1	-5.0	5.1	-25.8	-49.7
S&L Associations	22.0	6.5	14.5	18.9	32.7	32.9	43.0	43.4	35.5	27.9	49.3	51.0	44.9	34.2	24.3	20.8	17.4	26.6	19.3	3.8	-4.3	5.5	-21.1	-47.9
Mutual Savings Banks	2.2	1.5	4.8	5.1	19.3	5.0	7.4	7.2	7.2	3.5	3.8	5.1	5.0	4.7	2.2	0.4	-0.1	0.3	0.2	-0.3	-1.3	-1.8	-3.4	-1.8
Credit Unions	*	-0-	*	0.5	0.6	0.3	*	0.2	0.5	0.1	0.8	0.6	0.2	0.4	0.4	0.4	0.4	0.5	0.4	0.5	0.6	0.5	0.8	0.6
Insurance	6.1	11.7	10.1	19.0	22.2	9.1	5.8	6.2	5.9	8.6	4.7	3.0	4.5	6.8	8.7	10.6	8.9	10.4	8.1	10.0	9.5	8.0	7.9	11.6
Life Insurance Companies	6.1	11.7	10.1	15.2	17.8	8.1	2.1	1.9	5.6	7.8	4.8	2.7	4.0	6.2	7.8	10.2	8.9	7.5	8.3	7.0	6.9	4.7	4.2	7.7
Private Pension Funds	*	*	0.6	1.7	2.2	-0-	-1.6	-1.2	-0.5	*	*	*	0.1	0.2	0.2	0.4	*	*	0.1	*	0.2	0.4	0.9	0.9
State/Local Gov. Ret. Funds	*	*	*	2.9	2.2	1.0	0.8	0.3	0.9	0.9	-0.3	0.2	0.2	0.3	0.8	1.0	1.6	0.9	1.4	2.6	1.8	2.3	0.4	2.5
Other Insurance Companies	*	*	*	-0-	-0-	-0-	*	*	*	*	0.2	0.1	0.1	*	0.2	0.2	0.3	0.2	0.3	0.4	0.5	0.4	0.5	0.5
Finance Companies	1.4	2.0	3.7	-0-	1.8	5.7	2.8	2.2	2.4	-3.0	-2.2	-0.5	0.9	0.6	0.5	0.4	2.5	2.9	3.0	1.6	2.5	2.8	-2.6	2.3
REITS	--	--	--	--	--	6.0	4.4	3.5	7.1	0.3	-8.2	-4.4	-1.8	-0.7	-0.6	-0.5	0.9	-0.2	-0.9	-2.3	-1.6	-1.5	-0.6	-0.4

* Less than one-tenth of one percent
NA Not Available
Note: Annual data for 1981 is based on an average of the first three quarters of 1981 at seasonally adjusted annual rates
Source: Board of Governors of the Federal Reserve System, Flow of Funds Accounts, compiled by HUD Economics Division.

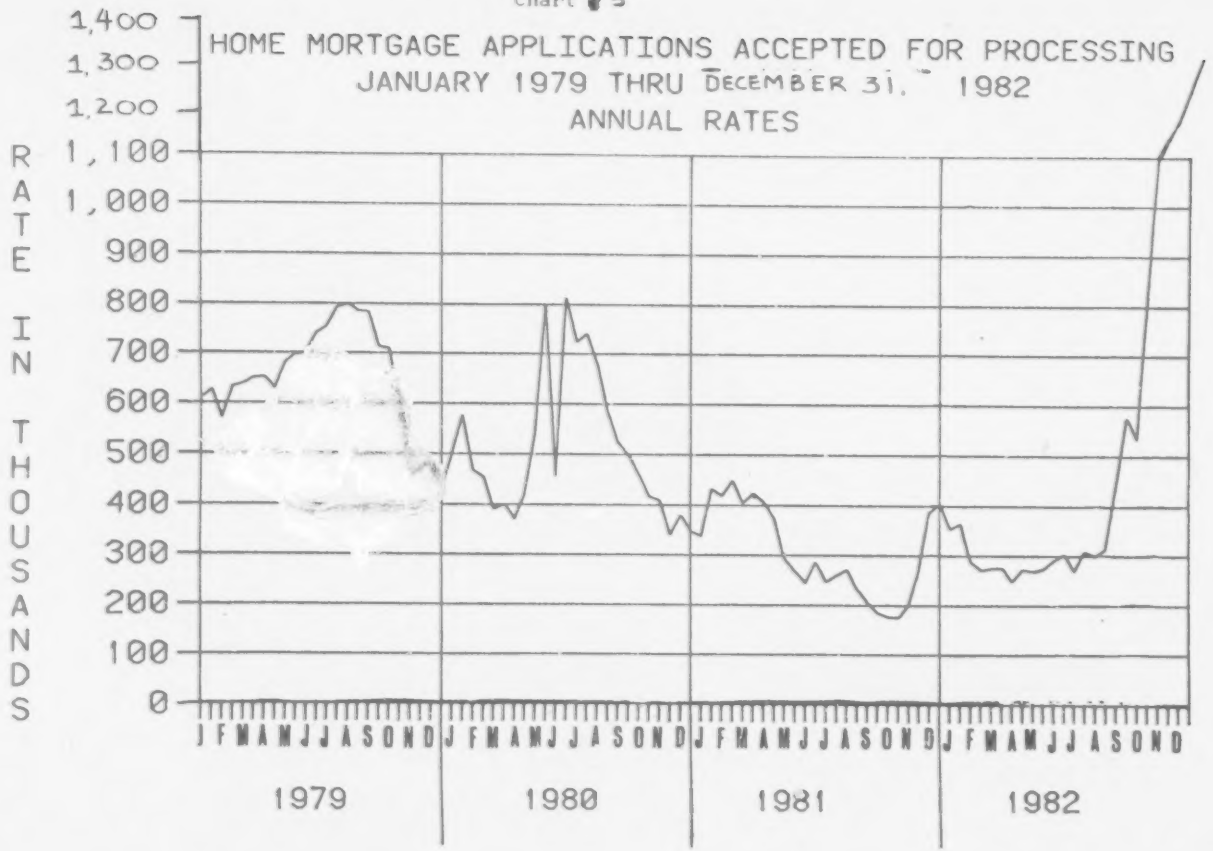
TABLE 19

The HUD field office jurisdictions listed below had the largest volume of applications for FHA single family mortgage insurance during December.

FIELD OFFICE	DECEMBER 1982	DECEMBER 1981	PERCENT INCREASE
Denver	4,425	1,394	217
Chicago	4,090	834	390
Houston	2,993	1,179	153
Phoenix	2,618	743	252
Washington, D.C.	2,554	796	220
Minneapolis	2,544	602	322
Los Angeles	2,443	798	206
Greensboro	2,009	582	245
Philadelphia	1,892	819	131
Seattle	1,878	621	202
San Francisco	1,700	337	404
Dallas	1,698	491	245
Baltimore	1,692	397	326
Santa Ana	1,682	466	260
Sacramento	1,676	402	316
New York	1,646	902	82
Fort Worth	1,645	643	155
Cleveland	1,639	425	285
Tampa	1,570	417	276
San Antonio	1,458	465	213

Source: FHA

Chart # 5



Source: FHA

Table 19

SELECTED CHARACTERISTICS OF NEW ONE-FAMILY HOUSES COMPLETED
(In thousands of units. Percents computed from unrounded figures)

Characteristics	Number of Houses					Percent Distribution				
	1981P	1980	1979	1978	1977	1981P	1980	1979	1978	1977
Total Completed	819	957	1,301	1,369	1,258	100%	100%	100%	100%	100%
Central Air-conditioning										
Installed	530	598	784	797	679	65	63	60	58	54
Not Installed	289	358	517	572	579	35	37	40	42	46
Bathrooms										
1 bathroom	165	171	204	207	219	20	18	16	15	17
1-1/2 bathrooms	81	93	139	137	165	10	10	11	11	13
2 bathrooms	378	439	618	659	590	46	46	48	48	47
2-1/2 bathrooms	195	235	340	367	284	24	25	26	25	23
Bedrooms										
2 bedrooms or less	172	163	178	163	140	21	17	14	12	11
3 bedrooms	487	602	828	879	834	60	63	64	64	66
4 bedrooms or more	160	192	295	327	284	20	20	23	24	23
Exterior Wall Material										
Brick	237	266	353	411	391	29	28	27	30	31
Wood or wood products	358	406	553	563	480	44	42	42	40	38
Stucco	91	122	164	176	155	11	13	13	13	12
Aluminum siding	70	89	137	146	136	8	9	11	11	11
Other types[2]	62	74	94	49	97	8	8	7	7	8
Fireplaces										
No fireplace	372	416	495	493	493	45	43	38	36	39
1 fireplace or more	447	540	806	877	766	55	57	62	64	61
Foundation										
Full or partial basement	273	340	542	580	554	33	36	42	42	44
Slab	384	433	516	547	478	47	45	39	40	38
Crawl space	162	184	244	242	226	20	19	19	18	18
Heating Fuel[1]										
Gas	339	394	512	511	476	41	41	39	37	38
Electricity	407	482	662	710	635	50	50	51	52	50
Oil	16	29	86	109	120	2	3	7	8	9
Other types	56	52	41	40	28	7	5	3	3	2
Heating System[1]										
Warm-air furnace[3]	458	541	727	781	977	56	57	56	57	78
Electric heat pump	202	233	323	336	(NA)	25	24	26	25	(NA)
Hot water or steam	26	36	62	85	67	3	4	5	5	5
Built-in electric	68	86	127	132	134	8	9	10	10	12
Other types	64	62	52	56	60	8	6	4	4	5
Parking Facility:										
Garage: one car	111	124	152	170	170	13	13	12	12	14
Garage: two cars or more	435	532	803	850	752	53	56	62	62	60
Carport	69	69	92	101	91	8	7	7	7	7
No garage or carport	205	231	255	248	245	25	24	20	18	19
Square Feet of Floor Area:										
Under 1,000	70	64	68	66	67	9	7	5	5	5
1,000 to 1,199	125	137	175	180	181	15	14	13	13	14
1,200 to 1,599	238	281	363	384	372	29	29	28	28	30
1,600 to 1,999[4]	161	206	305	327	475	20	22	23	24	38
2,000 to 2,399	100	124	191	216	(NA)	12	13	15	16	(NA)
2,400 and over	134	145	199	196	164	15	15	15	14	13
Average Size (square feet)	1,720	1,760	1,760	1,795	1,720	(X)	(X)	(X)	(X)	(X)
Median Size (square feet)	1,550	1,595	1,645	1,655	1,610	(X)	(X)	(X)	(X)	(X)

Note: Houses for which characteristics data were not reported have been distributed proportionally to those for which the data were reported.

P Preliminary. (NA) Not available. (X) Not applicable.

1 Data reflect only principal type.
2 Includes asbestos shingles, cinder block, stone, and other types.
3 Prior to 1978, includes heat pump.
4 Prior to 1979, houses with 2,000 to 2,399 square feet were included with those having 1,600 to 1,999 square feet.

Source: Department of Commerce, Bureau of the Census.

TABLE 15

MEDIAN PRICE OF NEW AND EXISTING SINGLE FAMILY HOMES SOLD
PERCENT CHANGE IN PRICES OF HOMES, AND CONSUMER PRICE INDEX

	New Homes		Existing Homes		
Year	Median Annual Price	Percent Change	Median Annual Price	Percent Change	CPI
1976	$44,200	+12.5%	$38,100	+ 7.9%	+ 5.8%
1977	48,800	+10.4	42,900	+12.9	+ 6.5
1978	55,700	+11.4	48,700	+13.5	+ 9.0
1979	62,900	+12.9	55,700	+14.4	+13.3
1980	64,600	+ 2.2	62,000	+11.9	+12.4
1981	68,900	+ 6.6	66,400	+ 6.7	+ 8.9
1982	69,300	+ 0.6	67,000	+ 1.9	+ 4.0

NATIONAL ASSOCIATION OF HOME BUILDERS
FIFTEENTH AND M STREETS, NORTHWEST
WASHINGTON, D.C. 20005

NAHB 1983 LEGISLATIVE PRIORITIES

FEDERAL BUDGET

NAHB urges the Administation and Congress to focus on practical ways to reduce the deficit. They must tackle the "big-ticket" items that heretofore have been ruled off-limits from the budget-cutting process. This would include scaling back on defense spending and containing the soaring costs of entitlement programs that, along with interest payments on the national debt, now account for 70 percent of the entire federal budget.

MORTGAGE INVESTMENT TAX CREDIT

NAHB supports a mortgage investment tax credit for investors in residential mortgages as an immediate and positive way to help assure mortgage money will be available in this decade to finance housing for the post-war baby boom.

MORTGAGE INVESTMENT INCENTIVES

NAHB supports legislation to provide incentives for mortgage investment through tax exempt savings targeted to housing. Tax-exempt savings such as Individual Housing Accounts (IHAs) or Individual Retirement Accounts (IRAs) could be used for a downpayment by first-time buyers.

PENSION FUND INVESTMENTS IN MORTGAGES

NAHB supports legislative changes that would remove the statutory and regulatory barriers that now inhibit pension fund investment in residential mortgages. NAHB urges Congress to remove the limitations and burdens that are imposed by statute, agency positions and by interpretations of the restrictive provisions of ERISA. Such legislation would put pension investment in mortgages on an equal basis with investments of other types.

MORTGAGE REVENUE BONDS

NAHB strongly supports elimination of the December 31, 1983, sunset for the single family program to permit the issuance of state and local tax-exempt mortgage revenue bonds after 1983. The revenue bond program has been an important source of housing finance.

DEPRECIATION

NAHB strongly supports continuation of present 15-year depreciation allowances for structures.

HOMEOWNERS' MORTGAGE INTEREST DEDUCTION

NAHB opposes any change in the tax treatment of homeowners' mortgage interest.

MULTIFAMILY

NAHB supports the development of new multifamily financing vehicles including a rental housing production program and methods for refinancing balloon mortgages on rental property.

TRUSTS FOR INVESTMENTS IN MORTGAGES (TIMS)

NAHB supports the concept of legislation which would promote the development of conventional mortgage-backed securities programs.

FHA/GNMA CEILINGS

NAHB supports workable and realistic ceilings for these programs to assure that they can accommodate the level of activity requested by applicants under the programs.

RURAL HOUSING

NAHB opposes changing the FmHA program to a block grant program. NAHB supports funding at FY'83 levels.

APPENDIX A

1983 Statement of Policy
National Association of Home Builders

January 25, 1983
Houston, Texas

Housing at the Crossroads

The nation's beleaguered but resilient housing industry -- still reeling from the effects of the longest and most devastating recession since the Great Dspression -- stands at an historic crossroads as it enters 1983. One path leads to economic recovery, a rebound in housing production and renewed public confidence. The other path puts the nation back on the same old merry-go-round of slow growth, volatile interest rates, record high unemployment, unacceptable budget deficits and political and social unrest.

The odds for recovery improved in October 1982, when the Federal Reserve Board shifted gears and gave the economy room to expand. As the FED eased its foot on the monetary brakes, the marketplace showed a spark of life. Interest rates declined; Wall Street rallied; home sales and new construction picked up; and demand for shelter showed signs of breaking loose after being bottled up for more than three years.

However, many critical problems remain unsolved that could delay, interrupt or even abort the anticipated recovery.

The recession of 1979-82 has cut deeper into the economic and social fabric of this nation than any since the Great Depression. More than 12 million Americans, including some 1.2 million in the construction industry, remain unemployed and business bankruptcies are still running near peak levels. While interest rates have declined, the real cost of money remains six percentage points above the rate of inflation. The rate of home sales and new construction -- though improved from a year earlier -- are still far below levels required to meet the shelter needs of this country.

Moreover, the 1983 outlook is clouded by continuing runaway federal deficits that threaten to break the $200 billion mark for the foreseeable future. Meanwhile, the mortgage finance system -- once the cornerstone of America's housing policy -- is still hanging in limbo after being rocked by shifting government priorities, bank deregulation, intense competition for savings and years of inflation and unpredictable interest rates.

This nation and this industry face a unique challenge at this turning point in American history. That challenge is to mount another housing-led economic expansion without reigniting runaway inflation. Meeting this challenge will require a delicate balance of fiscal and monetary policies. It will require bold, nonpartisan action and a spirit of cooperation and common purpose on the part of President Reagan, the United States Congress and the Federal Reserve Board. And it will require a renewed commitment to the goal of providing decent, affordable shelter for all Americans -- a goal first mandated by Congress in 1949 and reaffirmed since then by every Congress and every Administration.

Economic Policies

During the past two years, the economy has been seriously shaken by an explosive combination of fiscal, tax and monetary policies that are not only incompatible, but in direct conflict with one another -- creating a tug-and-pull in the marketplace. The most obvious was the Administration's attempt to rev up the economy with expansionary fiscal and tax policies -- the $1.6 trillion build-up in the national defense and a $750 billion tax cut. Simultaneously, the Federal Reserve Board was slowing the economy by reducing the nation's credit supply. This combination of policies sent interest rates and budget deficits soaring and deepened and prolonged the national recession.

By mid-1982 it became apparent that some mid-course policy corrections were needed to steer the economy away from the edge of the cliff. The Congress and the Administration subsequently adopted a major revenue-raising bill and a few months later, in October 1982, the Federal Reserve abandoned its doctrinaire experiment in monetarism. This shift in policies was followed by a free-fall in interest rates, a major rally on Wall Street and the modest beginnings of a recovery in the housing market. To maintain and to add to this momentum, some additional changes in policy will be required in 1983.

Reduce federal deficits. First and foremost on the agenda is the problem of skyrocketing federal deficits. The deficit for the fiscal year ending September 1982 reached a record $113 billion, more than twice the size of the Administration's original estimate. The federal deficit for the current fiscal year as well as fiscal years 1984 and 1985 could top $200 billion under current spending and tax proposals. Deficits of that size could open the door to another serious credit crunch down the road -- a development that would send interest rates soaring again and weaken, if not destroy, the recovery. This deficit crisis must be avoided.

To reduce projected budget deficits, the Administration and the Congress must tackle the "big-ticket" items that heretofore have been ruled off-limits from the budget-cutting process. This would include scaling back on defense spending and containing the soaring costs of entitlement programs that, along with interest payments on the national debt, now account for 70 percent of the entire federal budget.

Lower interest rates. As the economy catches its breath following three years of record high interest rates and tight money, it is vitally important that the Federal Reserve Board pursue a monetary policy that would permit a further decline in interest rates, giving both consumers and business access to affordable credit so desperately needed to turn the economy around. Any return to the monetarist policies of the past would choke off the economic recovery.

Create new jobs. Each one percentage point decline in the national unemployment rate cuts the federal deficit by an estimated $29 billion. The Administration and the Congress must pursue policies that will generate growth, bolster public confidence, put Americans back to work and help put the building industry back on its feet. A housing-led economic recovery is, by far, the best and most effective way to reduce the soaring deficit.

Housing's contribution would be significant. An additional 400,000 housing starts -- the difference between the 1 million units started in 1982 and the 1.4 million starts forecast for 1983 -- would create 700,000 new jobs, $13 billion in wages and $6 billion in additional tax revenue for local, state and federal governments.

Revitalize the Housing Partnership

Between the end of World War II and the beginning of 1983, entrepreneurs built more than 56 million homes and apartment units, and rehabilitated and restored millions more. America was transformed from a nation of poorly housed people into a nation of well housed property owners.

These great achievements didn't come easily. There were intermittent interruptions in the nation's housing delivery system. But this nation never lost sight of its ultimate goal to provide decent housing for all Americans. As the housing market grew and matured throughout the post-war period, a strong working partnership developed among the private building industry, the financial marketplace and government at all levels. Housing was ranked as a top national priority. It enjoyed strong bipartisan support as the nation's elected leaders recognized the economic, social and political benefits of a well housed nation. What was good for housing was accepted as being good for the country.

In the past, the federal government's role in the housing market has been focused in two primary areas. First, the government provided direct and indirect assistance to the poor, the elderly and disabled, who were unable to compete for housing in the private marketplace. Secondly, the government helped shape a financial system that gave home buyers access to long-term credit at affordable rates. For example, the government chartered specialized mortgage lending institutions, insured mortgage loans against default, created a sophisticated secondary mortgage market and permitted taxpayers to deduct mortgage interest and property taxes.

That partnership, unfortunately, has been badly shaken recently by changes in the economy and shifting government priorities at a time when the need for affordable housing is at an all-time record level.

The time has come for this nation's elected leaders to reaffirm their commitment to housing. By taking the best from the past and building on it, a dynamic partnership between government and private industry can be revitalized to make housing a top national priority again and to provide decent housing in a suitable living environment for every American family.

Strengthen the Mortgage Finance System

A long-term, national strategy needs to be developed to strengthen and stabilize the nation's mortgage finance system, focusing on ways to reestablish housing's priority in the financial marketplace and to provide home buyers with access to mortgage money at rates and terms they can afford.

This nation must eliminate the myth that America is overhoused and that too much credit has flowed into housing investment. That notion -- occasionally expressed by the President's top economic advisors - ignores the facts.

Providing favorable credit and tax treatment for housing is a policy worth preserving. This policy has been good for the American people and good for the economy. It has paid off in rich dividends, opening the doors to home ownership for millions of Americans and giving the average working man a stake and a sense of pride in this democratic society. The fiercely competitive housing system that emerged became a driving force behind the economic progress of the last four decades, providing jobs for millions and generating demand for goods and services throughout the economy.

To strengthen the mortgage finance system, immediate consideration should be given to the following programs and policies:

* Creation of a tax credit for all investors in residential mortgages, one of the most significant recommendations made by the President's Commission on Housing.

* Creation of tax-exempt Individual Housing Accounts -- another Presidential Commission recommendation -- as a way to encourage young Americans to save for a down-payment on a home.

* Adoption of legislative and regulatory reforms that would remove the obstacles preventing pension funds from investing in residential mortgages, also a recommendation proposed by the President's Commission on Housing.

* Elimination of sunset provisions for tax exempt revenue bonds, thus permitting the issuance of state and local tax-exempt mortgage revenue bonds after 1983.

* Development of new multifamily financing vehicles, including a rental housing production program and methods for refinancing balloon mortgages on rental property.

* Expansion of efforts to strengthen existing primary and secondary mortgage market mechanisms, including FHA/VA programs, GNMA, FNMA, and FHLMC, and support of legislative and regulatory proposals to expand the role of private mortgage-backed securities.

* Support and encourage private innovative financing concepts, such as NAHB's Home Mortgage Access Corporation, to give home builders direct access to the secondary market.

* Oppose any further direct involvement of financial institutions and their subsidiary corporations in the land development and building businesses.

Regulatory Reform for Affordable Housing

The fastest growing segment of the nation's housing market is made up of millions of young, first-time home buyers, nearing or in their 30s, who are in need of "affordable" housing. Builders have responded to this strong demand for starter homes by shifting to the development of smaller units, built on less land, with higher densities, modern layouts and amenities and innovative, energy-conserving features.

Some communities have moved much faster than others in taking positive steps to enable the building industry to meet the challenge of providing affordable housing. At a time when local governments should be looking for ways to encourage greater efficiencies in the production and delivery of new homes, some have stood adamantly behind rules and regulations that were written long ago, have since become outmoded, and are today a major impediment to the construction of affordable housing.

The issues of government overregulation of the housing industry are numerous and complex. In some areas, overregulation occurs in the form of excessive building fees that are actually an attempt of local governments, confronted by overburdened taxpayers, to balance their budgets on the backs of new home buyers just coming into the community. Sometimes, restrictive zoning regulations are imposed to fence out new growth. Elaborate and needlessly prolonged procedures for obtaining permits may be the result of understaffed building inspection offices. And many times, overregulation is simply the product of a lumbering bureaucracy that, once set in motion, never stops to consider the relevance of various inefficient codes to safety, health and the public good.

Whatever the cause, overregulation adds thousands of dollars to the cost of building housing and is therefore an excess this nation can no longer tolerate or afford.

To bring about regulatory reform of the housing industry, federal, state and local governments, with the support and cooperation of private industry and NAHB, should move quickly and forcefully to implement the major recommendations of the President's Commission on Housing. Specific recommendations on regulatory reform that deserve immediate attention are:

* Requiring federal agencies to prove the need for new regulatory actions through cost/benefit analysis and housing impact studies;

* Repealing zoning regulations that deny or unreasonably limit development of all types of housing;

* Updating density requirements so that they do not interfere with market forces;

* Promoting infrastructure development financed from general governmental revenues and in such a way that it does not unduly burden the housing consumer;

* Reducing fees and dedication requirements that exceed the actual costs involved in building new developments in the community;

* Streamlining the permit process to enable builders to break ground on their projects in as timely a manner as possible;

* Repealing rent control ordinances that lead to housing shortages and ultimately hurt the very people they are intended to help.

* Designing innovative and equitable programs at all levels of government to meet the housing needs of Americans unable to compete in the free marketplace without imposing mandatory inclusionary zoning ordinances.

Housing: Shelter for the People, Jobs for the Economy

A strong, competitive building industry is vital to the national economy. The industry provides shelter for the American people and jobs for the economy -- both of which are desperately needed during this period of near Depression-level unemployment and record demand for affordable housing.

The significance of a healthy housing industry goes far beyond providing shelter and jobs. The opportunity for Americans from all walks of life to work hard and to live in decent, affordable shelter, is the glue that holds together this free and democratic society. It gives Americans the drive and incentive to excel in their individual endeavors, to climb the ladder of success and to improve their standard of living. Equally important, it gives them a sense of self esteem and independence as well as a sense of pride and involvement in their local community.

Awesome challenges confront America in 1983. Seven times since 1946 the building industry has led the nation from recession to recovery. Now is the time for the Congress, the Administration, the Federal Reserve Board and private enterprise to work together for policies that will lead to lower interest rates, lower federal deficits, lower unemployment and provide decent, affordable housing for all Americans.

Board of Directors Action: Approved
Joint Executive/Resolutions Committee Action: Recommends Approval
Resolutions Committee Action: Recommends Approval

The CHAIRMAN. I'd like to emphasize why we asked not to be specific, is because I think most people know that this was a general oversight hearing. We will hold our specific legislative hearings on the President's request, here at the committee, and everybody will then have an opportunity to respond to specific legislative proposals and to present their own viewpoint.

Along that line also, Senator Tower is the new chairman of the Housing Subcommittee. He was not able to be here today. He's been traveling back from a meeting overseas, and will be back this evening. He will be conducting those detailed hearings as the chairman of the Housing Subcommittee.

Mr. Snyder.

STATEMENT OF HARLEY W. SNYDER, PRESIDENT, NATIONAL ASSOCIATION OF REALTORS

Mr. SNYDER. Thank you, Mr. Chairman, members of the committee.

My name is Harley Snyder. I'm President of the National Association of Realtors, and I'm pleased to be here today on behalf of the 640,000 members of our national association to present our views on the state of the housing market.

WORST DEPRESSION SINCE THE THIRTIES

The housing industry, Mr. Chairman, as you are keenly aware, has been suffering the worst depression since the thirties. During this 46-month period we have seen mortgage rates rise to a high of 17 percent and beyond. Homebuyers have been forced out of the market. As a matter of fact, during this 4-year period there has been a 56-percent decrease in resale activity in the United States. Literally 4½ million resale transactions have been lost, amounting to a market value of ⅓ of a trillion dollars. This does not take into consideration the impact that resales have on the general economy.

During 1982 we saw a 17½ percent drop in existing home sales from 1981. We also in 1982, saw only one-half of the needed housing starts that were identified in 1979 by a Government survey. That survey set housing goals of 2 million units per year. Fortunately, during the second half of 1982 we saw the beginnings of a recovery, brought about by a dramatic decline in interest rates. As a result of that decline, large numbers of consumers reentered the market. During the five consecutive month period of interest rate decline, we saw hundreds of thousands of people enter the market. Mortgage interest rates are now in the neighborhood of 13½ percent for a conventional fixed rate mortgage, and, of course, FHA/VA rates are 12 percent. Existing home sales increased by approximately 20 percent during the last half of 1982.

New homes during that period of time increased even more. In November and December there was an actual 46-percent increase above the July rate. Building permits increased significantly, as well.

In December, FHA processed loans on an annualized rate of some 1½ million applications.

The evidence clearly points to a recovery. In fact, I think that we can again see housing playing its traditional role in leading the

Nation out of recession. It is, indeed, encouraging, but I would suggest that there recovery is a fragile one, and must be protected.

Last year's budget resolution brought about lower deficits. Two reconciliation bills resulted in spending reductions and tax increases. These actions sent a message to the money markets which allowed reduction in interest rates. But the 98th Congress, will have to demonstrate similar fiscal responsibility if rates are to continue to fall and the economy to improve. New spending programs aimed at unemployment or housing, are clearly not the answer, in our opinion.

As a matter of fact, the Congressional Budget Office indicates that unemployment is so large that a Jobs Program would be of no help.

Of equal importance is that the resulting increase in the deficit could exert upward pressure on sensitive interest rates and, therefore, reduce available mortgage credit. These actions would, in turn, shatter the renewed dreams of homeownership that are held currently by many millions of Americans.

To preserve the homeownership opportunities, and satisfy housing needs, Congress must take steps to reduce the proportion of available capital that is siphoned away to finance Federal deficits.

The housing recovery will never happen as long as we have $200 billion deficits added to a $1.3 trillion debt.

One fact that we have learned as a result of these difficult times is that adequate supplies of mortgage credit are absolutely essential if we are going to have a healthy housing market.

The housing credit needs for the next decade are estimated at $1½ trillion. To meet these needs, it is clear that the traditional methods of mortgage finance must change.

For the past 40 years thrifts have sought savings, paid low interest on those savings, and offered affordable mortgages. No longer, however, is this the case.

During 1982, 30 percent of all the loans originated were sold in the secondary market, and we estimate that by 1990 some 80 percent of all loans originated will be sold to investors in the secondary market.

We must have new financial instruments available in order to compete with corporate securities, stocks, and the other instruments of investments in the Nation's capital markets.

CONVENTIONAL MORTGAGE-BACKED SECURITIES

The answer, in our opinion, is conventional mortgage-backed securities, without Federal insurance or support of any kind. We must bridge the gap between Wall Street and Main Street.

Last year, the National Association of Realtors supported legislation to enable depository institutions to compete in a deregulated financial environment. We now urge Congress to complete the task. To assure that mortgage credit has an opportunity to compete in the marketplace, barriers must be removed.

The President's Commission on Housing addressed the problem, and reported that mortgage-related securities are disadvantaged. Some changes have occurred through the SEC, the Federal Reserve

and the Department of Labor, and they have been helpful. However, more must be accomplished.

For example, the current tax code is a major problem.

Most of the needed tax changes fall under the jurisdiction of the Finance Committee, and we understand that, Mr. Chairman. However, this committee can assume a leadership role in seeking the changes.

We would call upon you and your committee to lead the way for a national summit of Government and industry leaders from all areas concerned with future housing credit needs.

This group of experts should undertake an in-depth focus of the legal regulatory and tax barriers that confronts the competitive ability of mortgage-backed securities so that a clear understanding of the necessary steps to be taken can be gained.

This focus could provide the critical momentum needed to overcome the existing and embedded obstacles.

Mr. Chairman and members of the committee, let me summarize. The housing industry is improving and should indeed continue to strengthen through 1983. However, only a modest recovery of housing can be expected until Federal deficits are reduced so that adequate capital is available for housing investment.

Also for the long run, action must be taken to improve the ability of mortgage-backed securities to compete in deregulated capital markets.

Mr. Chairman and members of the committee, we thank you for the opportunity to appear today.

The CHAIRMAN. Thank you, Mr. Snyder.

[Complete statement follows:]

STATEMENT OF HARLEY W. SNYDER ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS REGARDING THE STATE OF THE HOUSING INDUSTRY

I am Harley W. Snyder, a REALTOR from Valparaiso, Indiana and President of the National Association of Realtors. On behalf of the over 640,000 members of the Association, I appreciate the opportunity to submit our views on the state of the housing market.

INTRODUCTION

The housing industry is emerging from the deepest and longest depression since the 1930s. Over the course of that period, mortgage interest rates in the high-teens range were wreaking havoc with housing construction and home sales. Potential home-buyers were forced to the sidelines when faced with the severe affordability problems resulting from these high interest rates.

The poor health of housing can be seen by the following indicators:

During the 46 months of the downturn, resale activity across the nation plunged 56 percent.

During this cycle the nation has lost four and one-half million resale transactions with a market value of nearly one-third of a trillion dollars.

In 1982, alone, the loss in GNP due to lost single family starts and resales is estimated at over 106 billion dollars, with an accompanying loss in jobs of over 2 million.

Existing home sales in 1982 totaled 1.9 million units, a 17.5 percent drop from 1981, also a bad year.

Total housing starts amounted to only 1.1 million units in 1982, less than half the rate of total housing starts prior to the downturn.

This is far short of the general goals that government set back in 1979 when 2.2 million units per year appeared optimum.

HOUSING IN RECOVERY

In addition to being the worst year of the housing cycle, 1982 also marked the beginning of recovery. The second half of the year was marked by a striking decline in interest rates. At first, potential declining interest rates only increased home shoppers as homebuyers took a cautious wait-and-see attitude. By September, however, home sales began to edge upward as large numbers of consumers began to buy. Continued improvements in mortgage rates and improved housing affordability set the stage for recovery.

Mortgage interest rates declined from early November to early December. This was the fifth consecutive monthly decline for rates. In December, major mortgage lenders offered a commitment rate of 14.26 percent for conventional mortgages. Mortgage interest rates currently are in the 13.25 to 13.5 percent range, and FHA and VA rates are at a level of twelve percent.

The recovery can be measured by the following indicators:

Existing home sales showed modest improvement in September, followed by more substantial gains in the closing months of the year. December sales of existing homes totaled 2.2 million units on an annualized basis, up twenty percent over the mid-year level.

New home sales also improved significantly from mid-year to December. Although there was a drop in new home sales from November to December, the sales rate actually was 46 percent above the July rate.

The December 1982 number of building permits was 62 percent more than December 1981 levels. This rise will become apparent in the spring as construction picks up.

FHA applications showed the biggest monthly increase in volume in December—1.5 million on an annualized basis, compared to a mid-year volume of less than 400,000 on an annualized basis.

This evidence points to a recovery in the housing market and that the housing industry is beginning to play its traditional role in leading the economy to recovery.

New home construction, for example, generates sharp increases in employment in the construction trades, as well as stimulating activity in the lumber industry and other sectors of the economy used in building homes.

The resale market also contributes significantly to stimulating the national economy. Home sellers and buyers make many expenditures prior to, during, and following a resale. As a result, other businesses—painters, roofers, appraisers, lawyers, and the like—benefit from the sale of an existing home.

The relative importance of housing to the overall economy can be seen by looking at last year's activity:

Each new home built resulted in just over 91,000 dollars in GNP.

Each existing home sale contributed over 16,000 dollars to GNP. Since the ratio of existing sales to new sales is three to one, and because the resale market will rebound much faster, the aggregate impact of resale activity provides roughly the same stimulus to the economy as does new construction.

THE SHORT-TERM OUTLOOK FOR HOUSING

The importance of controlling Federal deficits

While the current upward trend is encouraging, it will take some time for the housing sector to return to full recovery. The fragile recovery we are seeing for the housing industry must be protected and nurtured in order to encourage a strong economic recovery for all industries. The key to maintaining this environment of lower interest rates so crucial to housing is Congressional control over expanding deficits.

Last year's Budget Resolution calling for a lowered deficit, followed by two Reconciliation bills which put into law spending reductions and tax increases, helped build the confidence of the money market to allow that decline in interest rates.

This year the Congress will have to demonstrate similar fiscal responsibility to maintain the current interest rate level and to allow interest rates to fall even further. New spending programs aimed at special concerns like unemployment or housing will not be as effective as deficit control. Even the Congressional Budget Office has pointed out the futility of throwing money at those concerns:

First, unemployment is so large that no jobs programs could help more than a small fraction of the unemployed. No housing stimulus bill could house the nation.

Second, and most importantly, the resulting increase in the deficit could exert upward pressure on interest rates and reduce the supply of mortgage credit, thereby shattering renewed dreams of homeownership.

In order to satisfy the housing needs of Americans, the Congress must take action to decrease the proportion of available capital that is syphoned away to finance federal deficits. The housing recovery will never happen under the current projection of 200 billion dollar deficits being added each year to a national debt of 1.3 trillion dollars.

THE LONG-TERM OUTLOOK FOR HOUSING

The importance of mortgage-backed securities

Mr. Chairman, one very important truth gleaned from our problems in the housing depression of the past few years is that adequate and affordable supplies of mortgage credit are essential to a healthy housing market. Recent experience makes a clear case that our current ability to meet housing credit needs is in question. Many of the right questions, incidentally, Mr. Chairman, have been consistently raised by you and this committee. This comes at a time when this country's housing credit needs will be substantial for the rest of the decade, over 1.5 trillion dollars. In order to meet this need, the way mortgages have been traditionally financed will also have to change.

For the past forty years we have had affordable mortgages originated and held profitably by depository institutions, primarily savings and loans, who derived their funds from inexpensive, regulated savings accounts. However, this system cannot function in today's economy. More and more mortgages will be sold by the lender that originated the loan to investors in the secondary market. While approximately thirty percent of all loans originated by lenders were sold in 1982, by the end of the decade over eighty percent of all mortgages will be financed by sales to investors in the secondary market. The question is: will the secondary markets be ready?

Perhaps the single most important factor in the ability of secondary markets to meet this country's housing needs is the development of new financial instruments that can compete with corporate securities, stocks, and other investments in the nation's capital markets. These instruments are conventional (i.e., private, without federal insurance or support) mortgage-backed securities.

Mortgage-backed securities enable investors unfamiliar with the business of mortgage lending to invest in familiar securities that, in fact, derive their income from the monthly payments of large "pools" of mortgages. What we must do is to bridge the gap between Wall Street and Main Street.

We are now at a point where the Congress has acted, with the active support of the NATIONAL ASSOCIATION OF REALTORS by enacting legislation to enable depository institutions to compete in an increasingly deregulated financial environment. We now urge you to finish the task by assuring that mortgage credit can compete in the same marketplace.

Mortgage-backed securities: What needs to be done

Unfortunately, there are barriers to the full development of mortgage-backed securities that diminish their competitiveness with other instruments; increase administrative costs of issuing these securities; and discourage new investors from the mortgage-backed security market. These problems were succinctly discussed in the report of the President's Commission on Housing which said, "Mortgage-related securities issued for sale in the secondary market currently are disadvantaged from a legal, regulatory, and tax standpoint in their competition with corporate debt obligations." At the National Association's recent mid-winter meetings, the Association endorsed legislative and regulatory action to enable mortgage-backed securities to compete for and provide America's mortgage credit. We hope you stand ready to assist in this effort.

In recent months several regulatory actions have implemented some of the Commission's recommendations. These regulatory changes include:

The SEC has allowed "blind pools" which enable securities to be sold before the actual mortgages are made.

The SEC has allowed "shelf registration" to reduce administrative costs for multiple issuances of similar mortgage-backed securities.

The Federal Reserve Board has amended Regulation "T" to allow mortgage-backed securities to be purchased on margin.

The Department of Labor has issued recent class exemption regulations to clear up some of the remaining mortgage-backed security investment disincentives for pension funds.

While these are positive steps, many other problems continue to hinder mortgage-backed securities, most of them in the tax code. I would like to briefly explain these problems. Under current law, the best method to form pools of mortgages that then

are backed by securities is under the "grantor trust" provisions of the Internal Revenue Code. Current Internal Revenue Service (IRS) regulations of the grantor trust require "passive management" of the mortgage as well as allowing only one type of security per pool.

Passive management means that, as loans in the pool are paid off, the repaid principal must be passed through, on a pro rata basis, to all the holders of the securities. This poses a major problem to investors such as pension funds that want stable investments that will be paid off on a predictable basis. This problem creates a need to provide investors with stable investments that cannot be paid off too early (what investors term "call protection").

With the current regulation of the grantor trust, only one type of security can be issued per pool of mortgages. Therefore, the term of the security will be fairly long-term, as long as mortgages in the pool are outstanding. Since only pension funds, insurance companies, and other institutional investors are well-suited to long-term investments, other investors are not attracted to mortgage-backed securities.

Many of the items we have mentioned are changes to tax laws and, therefore, come under the jurisdiction of the Finance Committee. However, this committee can certainly assume a leadership role in seeking these changes. Indeed, Mr. Chairman, we call upon you and your committee to lead the way for a national Summit of government and industry leaders from all areas concerned with future housing credit needs.

This group of experts should undertake an in-depth focus of the legal, regulatory and tax barriers that confront the competitive ability of mortgage-backed securities so that a clear understanding of the necessary steps to be taken can be gained. This focus could provide the critical momentum needed to overcome the existing and embedded obstacles.

Mr. Chairman, briefly, let me summarize. The housing industry is improving and should continue to strengthen through 1983. However, only a modest recovery of housing can be expected until federal deficits are reduced so that adequate capital is available for housing investment. Also, for the long run, action must be taken to improve the ability of mortgage-backed securities to compete in deregulated capital markets. Thank you.

The CHAIRMAN. Mr. Henry Schechter, we give you the honor of being cleanup batter today.

Mr. SCHECHTER. Thank you, Mr. Chairman.

STATEMENT OF HENRY SCHECHTER, DIRECTOR, AMERICAN FEDERATION OF LABOR/CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. SCHECHTER. Mr. Chairman and members of the committee, I appreciate the opportunity to present before you the views of the AFL–CIO on the state of the housing market.

The housing market poses a dilemma as far as 1983 and 1984 is concerned. I think every speaker who has appeared at this table before me today has indicated the interest rate problem.

Although we got an upsurge in housing starts—in housing sales and housing starts toward the end of last year, still for the last 2 months of the year we were averaging only a 1.3 million annual rate of housing starts. This was due in part to the decline in interest rates, from about 16 percent to about 13 or 14 percent, and also to pent-up demand, a pent-up demand which was very great.

But this pent-up demand, I would submit, is still only a thin layer of the total potential demand. Even with the current price of housing and a 13-percent interest rate, only the upper fraction of the entire family population can afford to purchase a house.

Let's take a $55,000 mortgage. A $55,000 mortgage is going to add up to about $850 a month in housing expenses, and there isn't too much potential demand at that level.

Moreover, most of those upper income families that can qualify are already well housed. It is the people who are actually looking for housing among whom we have only a thin demand.

So any rise in interest rates I think might very well lead to a decline of that rise in housing demand and starts. In the last few weeks we have seen a reversal of the downtrend in interest rates.

The bellwether Federal security rates, Treasury security rates, have turned up, and fragmentary evidence indicates that mortgage interest rates have also turned up.

CONSUMER CONFIDENCE WITH INCREASED EMPLOYMENT

Now in addition to the need to get interest rates to sustain or improve the recovery that has occurred in housing so far, there is also a need for greater consumer confidence, which would come, I think, with increased employment.

As long as we have an unemployment situation where, as projected in the President's economic report, in 1986 we would still have an 8 percent unemployment rate, and it is going to be very difficult to get moving toward higher housing production.

At the same time, we have a short supply of housing production in many areas. Although the Secretary of HUD says in the aggregate there is no shortage, he has allowed that in a few places shortages do exist.

If we have a surplus of housing in some town or city that is declining in population, it is not going to help us meet the shortages in the places where there is a scarcity of housing.

There is a particular need for rental housing. And if the economy does begin to recover, and given the financing the Federal Government has to do, the likelihood is that the most recent upward movement in interest rates will continue. That would be the end of our housing boom.

I would like to dwell for a moment on two other points. Certainly, the AFL–CIO will endorse mortgage relief payments to stave off foreclosures. The unemployed people who are not receiving additional benefits—half of the unemployed have run out of their unemployment insurance benefits—simply will not be able to hold on to their house unless they get some temporary relief, with the hope that they can return to work later.

As long as we get large numbers of homes being foreclosed, it will lead to market distress because those foreclosed homes go on the market at distressed prices.

Finally, I didn't put much in my statement about reduction in deficits because I took for granted everybody thinks about these things. But generally, this morning the reduction of deficit has been equated with reduction of expenditures.

Now we have had during the last couple of years some reductions in expenditures. To a large extent, those reductions have been reductions in programs that benefit people who are getting some of their food, some of their housing, some of their medical care, some of their educational assistance through the Federal programs.

To the extent that this has been cut back, that means cutbacks in demand in the economy. We have had a great reduction in purchasing power and demand in the economy, and the result is not

only historically high unemployment, but also a 67 percent level of utilization of our manufacturing capacity at this time. It is a third of our manufacturing capacity that is idle, and it is vital.

REVISIONS OF THE TAX CODE

So of course, the tax reductions that we had will not be an incentive for investment. In order to pick up the economy, we would favor greater stimulus, and in order to reduce the deficit without doing much harm to purchasing power, we believe there should be some revisions of the Tax Code to really roll back some of the tax reductions that we had in 1981.

For example, if we put a $700 cap on the tax cut for the third year, it really would affect only those with incomes of about $45,000 and up. I don't think that it would reduce the demand in the economy by very much. In other words, these people can afford to maintain their standard of living.

Over the next 3 years, by 1986, this would generate about $20 billion in additional revenues. If we were to repeal indexing, we would get another $32 billion over 3 years. We believe that would be a way to go about it.

And I have a whole list of additional loopholes that might be closed, which would add up to about $195 billion in 3 years. I would like to submit this for the record. This could be a way of reducing the deficit, while at the same time it would be possible to increase assisted housing, without getting into details, that would serve low income people and stimulate the economy.

One last word on the money market accounts. I think the significance of the great influx of funds to the money market accounts is not the amount, but in effect that households have changed in form from years ago. The people are ready and able to move their funds to the highest yield very quickly, and this will continue to happen, and I would just emphasize, with Mr. Shane, that we cannot really expect a great deal of mortgage financing for long term with that type of flow of funds around the economy.

He used the word "control of credit." I use the expression very frequently. I want to look at the details, but I think we need something along those lines. Otherwise, we certainly aren't going to have credit that will give us the housing we need.

Thank you.

[The complete statement and copy of list referred to above follow:]

83-10

Statement of Henry B. Schechter, Director
Office of Housing and Monetary Policy
American Federation of Labor and
Congress of Industrial Organizatons
on the State of the Housing Market
Before the Housing and Urban Affairs Subcommittee
U.S. Senate Committee on Banking, Housing, and Urban Affairs

February 14, 1983

SUMMARY

I appreciate the opportunity to present before you the views of the AFL-CIO on the state of the housing market.

Housing sales and starts during 1983 and 1984 will be influenced largely by the movement of interest rates. In the latter half of 1982, mortgage interest rates followed the general decline in interest rates. As conventional home mortgage interest rates came down from about a 16 percent to a 14 percent level, new home sales improved. Housing starts ranged about a 1.1 million annual rate, which accelerated to a 1.3 million average for the last two months of the year.

The downward trend of interest rates continued for the first couple of weeks in January, but since then the trend seems to have reversed. In recent weeks, the bellwether yields on Treasury notes and bonds have moved upward, and mortgage interest rates have begun to follow. Given the median prices of new homes at above $70,000 and a 13 percent mortgage interest rate, it is only those families in the upper one-third of the income distribution who could afford to carry such homes. It is unlikely that the level of new housing starts could increase or even be sustained for many months unless interest rates come down by a few more percentage points.

The rise in home building activity in late 1982 was due not only to the reduction in interest rates but also to the vast pent-up potential demand for housing. For the past three years, the average annual number of new housing starts has been about 1.1 million; even after adding mobile homes and units gained from

conversions, production was still far below the number required to accommodate net household formation increases and replacement of units lost from the supply. There has been a significant increase in families living doubled up.

Despite that potential demand, the economic conditions are not conducive either to the assumption of high housing expense obligations through home purchases or the development of rental housing financed at current interest rates. If there is no increase in production levels to begin to make up for the shortfall over the last few years, there will be a chronic tight supply of housing in many areas which will cause housing to remain a leading factor of inflation in the economy. During 1982, the 6.6 percent increase of rents outpaced the 3.9 percent increase in the total Consumer Price Index.

If the economy does not have a faster recovery than is contemplated, the continued high unemployment will remain a drag on housing demand directly, and indirectly because of weak consumer confidence. If the economy should begin to pick up in a significant fashion, interest rates are likely to rise because there will be increased demands for credit to finance more home purchases and to rebuild inventories in the supplier industries and also in other parts of the economy. Higher interest rates would most likely lead to a downturn in one-family housing production before the end of 1983.

There is even more likelihood of a downturn in multifamily construction because the condominium boomlet of 1980-81 collapsed in 1982 along with the economy, as speculative construction and ownership of condominium structures became unprofitable and, in some cases, ended in foreclosures. High interest rates greatly constrain the market for unsubsidized rental housing. Federally assisted low-rent housing construction is being curtailed to a level approaching zero, in a policy shift to a program of vouchers that low-income families could use to help

pay rent of existing units they can find in the market. A sizeable expansion of demand without a matching increase in supply will increase inflationary pressures.

There are two policy options that could be pursued to produce a better level of housing activity in the future. The first would be further reductions in interest rates through Federal Reserve easing of monetary policy. If this policy is not pursued because there are fears that it would reignite inflation, there should be resort to credit controls such as were used in 1980 to bring down interest rates quickly. Home building rapidly rose and so did the economy in its wake.

The other policy, which could be pursued at the same time, would be to reverse the downward trend in federally assisted housing construction. With the addition of about $15 to $16 billion in budget authority to be committed in fiscal years 1983 and 1984, it would be possible to support the production of about 200,000 units of assisted rental and homeownership housing for low-and moderate-income families. This could include housing for the elderly as well as family housing, Indian housing, and rural housing. The expenditure of that budget authority would be spread over 30 to 40 years in annual assistance payments outlays.

Interest Rates and Housing Production

The housing outlook for 1983 and 1984 will be determined largely by the movement of interest rates. And for years that follow, the housing market will also be influenced by what has happened to housing production in 1983. If the housing supply is not increased through an increased level of production, relatively high inflation of prices and rents will be prevalent.

Housing sales and construction had reacted in customary positive fashion to a decline in interest rates which took place in 1982. Between May and November, yields on Treasury three-year and ten-year notes declined from 14 1/8 and 13 3/4 percent to 9 3/4 and 10 1/2 percent, respectively. In February 1983, however, the

yields on new issues of three-year and ten-year Treasury notes rose to 9.98 and, 10.94 percent, and on 30-year bonds it rose from 10 3/8 percent in November to 11 percent.

Month	Yields on New Issue Treasury Securities			Effective Interest Rates on all Conventional Home Mortgage Loans
	3-Year Rate	10-Year Note	30-Year Bond	
	(percentage yield)			(percent)
1982				
February	14 5/8	14 5/8	14	15.60
May	14 1/8	13 3/4	not issued	16.11
August	13 1/8	13 3/4	not issued	15.65
November	9 3/4	10 1/2	10 3/8	14.20
1983				
February	9.98	10.94	11.01	not available

Customarily more sticky, mortgage interest rates on conventional home loans declined by almost two full percentage points from about 16 percent in May to about 14 percent in November and slightly below 14 percent in December. Interest rates on mortgages for which builders obtained advance commitments remained above 14 percent in December.

There are no published data available yet on mortgage interest rates for January or early February; however, the Wall Street Journal of February 1 carried a feature story which started as follows: "After a 6-month free-fall, fixed mortgage rates are rising again. In the past three weeks, fixed mortgage rates have jumped to as much as 13.5 percent from a low of 12.75 percent on loans that are not backed by government insurance or guarantees." The article went on to say that on 12 percent government-insured mortgages the points paid to obtain such loans had

increased from 1.5 percentage points to as much as 6 percentage points. Apparently, as ususal, mortgage interest rates with some lag are following the general trend of other interest rates, which has been upward in recent weeks.

During the latter half of 1982, as interest rates declined, housing sales and starts began to pick up from a level of about 900,000 in June. The seasonally adjusted annual rate of housing starts was generally in a range between 1.0 and 1.2 million in the months of July through October. In November, there was a big spurt, followed by a decline in December. However, for the last two months of 1982, the seasonally adjusted annual rate of new unit starts averaged about 1.3 million. This reflected a demand with conventional mortgage interest rates in a 13 to 14 percent range and effective mortgage interest rates on government-insured loans in a 12 to 13 percent range. In light of what happened in November-December, the forecasts of housing starts for 1983 generally have ranged between 1.3 and 1.5 million.

Market Demand for Homes

It was not only the decline in interest rates which led to the November and December rise in home sales and housing starts, there had also developed a great pent-up demand. For the three years ending with 1982, the average annual number of new housing units started was about 1.1 million; including the number of mobile homes shipped, brings the annual average up to between 1.3 and 1.4 million new units produced. That did not even equal the annual average increase of 1.5 million households. In addition, units are needed to replace several hundred thousand lost from the supply each year plus additional vacant units to permit migration and mobility and to offset the absorption of second homes for seasonal and other purposes.

During the years of the shortfall of housing production relative to need, housing prices and rents, as well as interest rates, rose to place housing out of

TABLE 1

Median Prices of New And Existing Homes Sold
and Mortgage Interest Rates

	Median Home Prices		Mortgage Interest Rates
	New	Existing	Conventional Home Loans* (percent)
1981: July	$ 69,500	$ 67,500	15.10
Aug.	72,600	68.100	15.45
Sept.	65,800	67,100	15.70
Oct.	69,600	66,000	15.89
Nov.	71,200	65,900	16.37
Dec.	68,400	66,600	15.98
1982: Jan.	66,200	66,400	15.69
Feb.	65,700	66,900	15.60
Mar.	67,200	67,000	15.67
Apr.	70,200	67,100	16.00
May	69,300	67,800	16.11
June	69,300	69,400	15.55
July	70,900	69,200	15.60
Aug.	70,100	68,900	15.65
Sept.	67,700	67,300	15.21
Oct.	69,500	66,900	14.83
Nov.	73,900	67,700	14.17
Dec.	71,700	67,500	13.95

* Federal Home Loan Bank Board —effective rate in the primary market, reflecting fees and charges, as well as interest rates, assuming repayment on average at end of 10 years; new and existing home loan.

TABLE I

National Average of Interest Rates
on Conventional Home Mortgages
for which Commitments are Issued*
1978-1982

1978	9.69
1979	11.27
1980	14.00
1981	16.71
1982	16.59
1982	
Jan.	17.34
Feb.	17.50
Mar.	17.51
April	17.39
May	17.28
June	17.16
July	17.23
Aug.	17.01
Sept.	16.18
Oct.	15.62
Nov.	14.63
Dec.	14.26

*Average for all types of lenders for loans with 75 percent loan-to-value ratios and 25 year maturities

Source: Federal Home Loan Bank Board

TABLE 3

Total Private Housing Starts, Annually 1978-1981; Monthly at Seasonally Adjusted Annual Rates 1981

Year or Month	Housing Starts (in thousands of units)
1978	2,020
1979	1,745
1980	1,292
1981	1,084
1982	1,061
1982	
Jan.	885
Feb.	945
Mar.	931
April	882
May	1,066
June	908
July	1,193
Aug.	1,033
Sept.	1,129
Oct.	1,126
Nov.	1,404
Dec.	1,222

reach of many families. There was an increase in families living with other families as subfamilies. The number of such families had been down to 1.35 million in March 1978. It rose in the next several years, reaching 2.25 million in 1982 -- the highest level since 1964. The number of unrelated individuals living with others also increased from 23.4 million in 1978 to 27.9 million in 1982.

The figures that have been cited suggest first that the pent-up demand was a large factor in the surge of a demand for homes in late 1982. The supply was still tight enough so that when the annual rate of sales of new homes increased 13 percent to 563,000 in November, in response to lower interest rates, the median price of a new home rose to $73,900. It did fall back to $71,700 in December. Existing home sales also picked up; and as interest rates came down, the median price of existing homes sold reversed a downtrend and rose from 66,900 in October to 67,700 in November.

Even at a 13 percent mortgage interest rate, with a $55,000 30-year loan and other housing expenses, total housing expenses will run to $827 a month, which would require an income between $30,00 and $40,000 a year depending upon what portion of income -- between one-fourth and one-third -- is devoted to housing. Only about the top one-fifth to one-third of all families in the income distribution have the income required to meet such housing expenses. Most of these upper-income families are also well housed. The late 1982 upsurge in sales and starts, therefore, probably represented a thin layer of demand at the 13 percent mortgage interest rates. As Judith Mackey of Townsend-Greenspan recently said, "To get a sizeable segment of the population to qualify for loans at these [current] prices, would require single digit interest rates." It will probably require further reduction of interest rates to sustain even a 1.3 million annual rate of housing starts through most of 1983, let alone to bring production up to a higher level. In

TABLE 4

Thousands of Unrelated and Related
Subfamilies Living with Other Families
as of March of Each Year

YEAR	UNRELATED	RELATED	TOTAL
1950	465	2,402	2,867
1955	219	1,973	2,192
1960	207	1,514	1,721
1970	130	1,150	1,280
1971	125	1,238	1,363
1972	133	1,253	1,386
1973	109	1,250	1,359
1974	137	1,178	1,315
1975	149	1,349	1,498
1976	189	1,190	1,379
1977	238	1,176	1,414
1978	257	1,093	1,350
1979	306	1,056	1,362
1980	360	1,150	1,510
1981	393	1,236	1,629
1982	372	1,877	2,249

Source: U. S. Department of Commerce, Bureau of Census, "Households, Families, Marital Status and Living Arrangements" as of March of each year, Series P-20.

TABLE 5

Interest Rate	Monthly Principal and Interest 1/	Other Housing Expenses 2/	Total Housing Expenses	Income Required if Housing expenses equal 25% of income 3/	...33% of income	Percent of families able to afford with 25% of income	Number of families (millions)	Percent of families able to afford with 1/3 of income	Number of families (millions)
8½	$ 423	219	$ 642	$ 30,816	$ 23,345	32.3	19.7	48.1	29.3
9	443	219	662	31,776	24,073	30.3	18.5	46.3	28.2
9½	462	219	681	32,688	24,763	28.5	17.4	44.6	27.2
10	483	219	702	33,696	25,527	26.4	16.1	42.9	26.2
10½	503	219	722	34,656	26,255	24.5	14.9	41.5	25.3
11	524	219	743	35,664	27,018	23.1	14.1	39.9	24.3
11½	545	219	764	36,672	27,782	22.1	13.5	38.3	23.4
12	566	219	785	37,680	28,545	21.1	12.8	36.8	22.4
12½	587	219	806	38,688	29,309	20.1	12.2	35.3	21.5
13	608	219	827	39,696	30,072	19.1	11.6	33.8	20.6
13½	630	219	849	40,752	30,872	18.1	11.1	32.1	19.6
14	652	219	871	41,808	31,673	17.0	10.4	30.5	18.6
14½	674	219	893	42,864	32,473	15.9	10.0	28.9	17.6
15	695	219	914	43,872	33,236	14.9	9.1	27.4	16.7
15½	717	219	936	44,928	34,036	13.9	8.5	25.7	15.6
16	740	219	959	46,032	34,872	12.8	7.8	24.1	14.7
16½	762	219	981	47,088	35,672	11.8	7.2	23.1	14.1

1/ Assumes a $70,000 home, $55,000 loan for 30 years at varying interest rates.

2/

Hazard insurance	$28.05	)
Real estate taxes	60.16	)
Maintenance	37.59	) Based on FHA projected expenses for new homes,
Heat & Utilities	93.26	) Third Quarter, 1982.
	$219.06	

the absence of lower interest rates, a decline from the 1.3 million housing starts rate is likely to occur before the end of 1983.

Another element needed to sustain a high level of demand for homes is consumer confidence. That was not established by the January one-month decline in the unemployment rate. As the Labor Department reported, "Total employment was unchanged in January -- seasonally adjusted." That was based on the basic measure, the survey of households. The report also stated: "Nonfarm payroll employment -- as measured by the monthly survey of establishments -- rose by 340,000 in January, after seasonal adjustment." Finally, the report read: "The number of unemployed persons increased by less than usual from December to January and, as a result, the seasonally adjusted level declined by 590,000 to 11.4 million." There was also a dramatic jump in the average length of unemployment in January, from 18 to 19.4 weeks. Many long-term unemployed may have been among the estimated 579,000 people who withdrew from the work force, which would contribute to a decline in the unemployment rate. There is still a widespread basis for a lack of consumer confidence, as well as a substantial erosion of consumer purchasing power, which will act as a drag on the housing market and the economy.

Another more direct negative impact on the housing market also has been developing as a concomitant to widespread, extended unemployment. That is a rising level of home foreclosures. From the third quarter of 1981 to the third quarter of 1982, the percentage of all home mortgage loans covered in the Mortgage Bankers Association survey that were in foreclosure process increased from 0.41 to 0.62 percent, a record high. If this level continues to increase, foreclosed homes going on the market can become a significant deterrent to new home sales, financing and production.

18-535 O—83——15

It would seem that an unusually mild January permitted construction and retail activity to proceed with less than a usual decline. At the same time, in the first four weeks of January, a total of 2,455 business failures was 55 percent above that of the comparable 1982 period. The President's Economic Report projection of a 10.7 percent average unemployment rate for 1983 is not ruled out by a 10.4 percent rate in the first month.

If the economy, however, should be moving into a period of measurable real growth, there is bound to be increased demand for business credit. That would be in addition to rising demands for housing credit and the large Treasury borrowing which must be met in 1983. Adding to the pressures for higher rates is the competition for household savings among the recently deregulated depository institutions and other investment intermediaries. The need to pay high money market rates can force lenders to keep mortgage rates at levels too high to sustain even the present level of home building activity.

Multifamily Housing Construction

Multifamily housing now includes owner-occupied as well as rental units. Structures with five or more units may now be condominiums or cooperatives with owner-occupied units, or rental apartments.

In the four years after 1978, while the annual total of new residential units being started was declining, the proportion in structures of five or more units increased from year to year, rising from 23 percent in 1978 to 30 percent in 1982. Between 1981 and 1982, the number actually rose from 288 to 319 thousand. These relative gains of multifamily housing production reflected a significant rise in the condominium, and to a far lesser extent cooperative, housing construction. Such gains are shown by the following data, which also indicate a downward trend in the speed of market absorption of condominium and cooperative units.

Year	Total Condo and Cooperative Units Completed	Condo and Coop Unit Completions as a Percent of All 5+ Completions	Percent of Condo and Coop Completions Absorbed Within Three Months
1979	91,800	21	75
1980	122,900	30	72
1981	112,600	34	62
1982 (first half)	53,300	37	54

Condominium construction had flourished in the early seventies, but often with only relatively short-term construction financing which could not be refinanced at terms that would still leave the units marketable when interest rates rose sharply in 1973-74. In the late seventies, early eighties, the poor image established by failing condominiums in the mid-seventies had vanished, and the market for new "condos" again supported a growing volume of such construction.

In the more recent upsurge of condominiums, long-term financing arrangements were generally made prior to construction, unlike the early seventies. Like in the earlier period, however, the condominium boom served two types of markets: (1) in areas of favorable climate, such as southern Florida and Arizona, where many of the units served the owner-occupants as seasonal second homes, and a high proportion of the owners were retired; and (2) in large metropolitan areas where almost all of the units were sold for occupant use as primary residences. In some of the warm climate areas, according to anecdotal reports, during the 1980-1981 period, there were numerous individuals who purchased two or more condominium units, either for speculation and resale, or as rental property investments. As interest rates caused the carrying costs to become too high and the 1981-1982 recession also caused the market to shrink, speculative purchasers retreated; and the warm weather area condominium boom collapsed.

In other areas, where the condo market was for primary residences, most large condominiums had long-term financing arranged prior to construction with then prevailing high interest rates. Upon completion, one or more years later in a depressed economy, the units were not marketable. There have been some well-publicized foreclosures or other takeovers of properties from developers by lenders. This has also happened in instances of conversions of older apartment structures from rental to condominium status. In some instances, the lender or the original developer has sought to operate the property, at least temporarily, as a rental property. Some of these operations may have contributed to a rise in the rental vacancy rate.

In the rental market, rents have been rising, reflecting, in part, the higher contractual interest rates of prior months when new structures were being started. The Census Bureau reported that asking rents on new unsubsidized apartments completed in the second quarter of 1982 rose by 8 percent from the first quarter level. There was also an 8 percent increase in the median rent for all vacant rental units between the second and third quarter. Over the past year, rents rose at a 6.6 percent annual rate versus 3.9 percent for the overall Consumer Price Index.

Rental Markets and Federal Assistance

As unemployment grew to a 12 million level toward the end of 1982, there was some loosening of the housing supply in local areas where economic conditions were leading to increased vacancies. In part, this occurred because unemployed and less-than-fully employed people, whose income had been reduced or cut off, were doubling up or leaving town. The rise in rental vacancies was greater in areas suffering greater economic setbacks, as indicated by the following data available from Advance Mortgage Corp. surveys.

TABLE 6

Consumer Price Index (CPI-U) Percent Change over the Year 1978-1982

	All Items	Residential Rent
1978	9.3	7.2
1979	13.9	8.1
1980	11.7	9.1
1981	8.4	8.4
1982	3.9	6.6

Source: Bureau of Labor Statistics

Market Area	Period	Change in Rental Vacancy Rate
Dallas-Ft. Worth	Sept. 1981-Sept. 1982	no change -- 5 percent both dates
Atlanta	Oct. 1981-Oct. 1982	3.1 to 4.6 percent
Minneapolis	Sept. 1981-Sept. 1982	3.9 to 4.4 percent
Los Angeles-Orange County	Sept. 1981-Sept. 1982	1.8 to 1.6 percent
Seattle	Oct. 1981-Sept. 1982	4.9 to 8.0 percent

For the U.S. as a whole, the rental vacancy rate rose to 5.5 percent at the end of 1982, a moderate rate in historical perspective. A 4.1 percent rate in the Northeast region of the country evidenced the fact that in many localities the rental housing supply was still tight.

Even in the areas where the rental market had loosened up some, the rents were still too high for those who encountered extensive unemployment and those who migrated elsewhere seeking employment.

In the depressed economic environment of the last year, there have been a growing number of newspaper stories and television reports that suggest an increase in the number of homeless people. Some reports are of cities in which overnight shelters are filled, so that people are turned away to sleep in the streets, abandoned buildings, and parks. A little over a week ago, there was a report of a death due to a fire in "tent city" -- a park camping area of Houston, Texas, which had become a disappointing mecca for job seekers. Workers had come with their families and were living in tents on the camping site. After the fire, they were forced to move elsewhere.

Given the high rents of newly completed units financed with high interest rates, they could serve only families with above-median incomes. Lower income families would be dependent mostly on subsidized housing programs. However, there has been a decreasing volume of new construction of subsidized rental housing in recent years and the Administration proposes further cutbacks, as follows:

Fiscal Year	Total number new and substantially rehabilitated low-rent housing units to be supported by budget authority under Section 8 and public housing programs
1980 actual	129,000
1981 actual	110,000
1982 actual	39,000
1983 estimated	16,000 (elderly)
1984 proposed	10,000 (elderly)

Actual starts of new rental units under the HUD low-rent programs, primarily from authority obligated in prior years, would decline from 113,000 in fiscal year 1982 to 72,000 in fiscal 1983, and 45,000 in fiscal 1984.

In a policy shift, the Administration seeks to economize by providing low-income families with vouchers to be used to pay part of the rent in existing units that they could find in the private rental market. For the same years, budget support has been and would be provided for existing unit rental and moderate rehabilitation rental unit programs as follows:

Fiscal Year	Existing Unit Rentals	Moderate Rehabilitation Units
1980 actual	50,235	26,167
1981 actual	53,947	24,981
1982 actual	23,418	6,799
1983 estimated	67,146	0*
1984 proposed	80,000	0

*HUD (the Administration) proposes zero, although Congress' Continuing Resolution for fiscal 1983 provided funds for moderate rehabilitation of 15,00 units and called for such use of the funds in the Senate-House Conference Report on the resolution.

The rationale for such a shift in policy to almost complete reliance on use of existing units to house assisted low-income families is that rents and required subsidies will be lower than in newly constructed units. However, since vouchers would increase demand without increasing supply, they must lead to a rise in rents until a matching increase in supply is built, which may take several years. In the

interim, it would unleash strong inflationary pressures for increases in residential rents, a component which already significantly outpaced the total Consumer Price Index in 1982.

At the same time, there is a crushing need for additional low-income rental housing. This was documented in a survey of waiting lists of 25 local housing authorities around the country made by the Council of Large Public House Authorities in 1982. It was found that the 25 housing authorities which, in total, had 204,575 housing units, had waiting lists which totalled 221,837. This total would have been larger if some of the authorities had not closed their lists to additional family applicants because they considered it the perpetration of a hoax to accept an application from families who would not be able to obtain a unit for years. While many authorities reported that elderly households might obtain a unit in from one to six or twelve months, for families the outlook generally was for a wait of at least one year, more often three years and sometimes as long as ten years.

Even more than in the case of single-family homes, given the present level of interest rates, the unassisted private market can only provide new rental housing that is affordable by a relatively small proportion of families -- those in the upper part of the income distribution. Given the low probability of a reduction of mortgage interest rates to a significantly lower level, the continuing reduction of federally assisted low-income rental housing, and the depressed level of the condominium market in an uncertain economy, there can be little hope for an upturn in multifamily housing construction. This means there is also little hope that the private market will meet even middle-income, let alone low-income rental housing needs.

TABLE 7

Number of Applicants on Waiting Lists
of Selected Housing Authorities

Local Housing Authority	Number of Housing Units	Number of Applicants
1. Akron	4,500	8,593
2. Atlanta	15,300	5,622
3. Boston	12,800	5,700
4. Cambridge	1,800	1,150
5. Chicago	46,800	23,473
6. Cincinnatti	6,800	2,424
7. Cuyahoga Metro (Cleveland)	11,550	2,445
8. Harrisburg	1,500	508
9. Kansas City	2,200	793
10. Los Angeles	8,200	4,353
11. Memphis	6,800	2,442
12. Miami	11,125	30,480
13. Minneapolis	6,900	1,058
14. Mobile	4,100	1,000
15. New York City	147,000	90,000
16. Omaha	2,900	350
17. Philadelphia	23,000	14,352
18. Pittsburgh	9,700	6,627
19. Portland, Oregon	2,300	1,528
20. Rochester	2,400	1,434
21. St. Paul	4,300	886
22. San Antonio	7,300	3,137
23. Seattle	6,000	3,490
24. Washington, D.C.	11,200	8,992
25. Wilmington	2,600	1,000
	204,575	221,837

Source: Council of Large Public Housing Authorities, Report #82-8 Survey of Waiting Lists of Selected CLPHA members and Other Large PHAs, 7 Marshall Street, Boston, Mass. Dec. 1982

Options for Increased Housing Production

The interest rate restraints upon a sustainable expansion of effective market demand for unassisted ownership and rental housing and the contraction of federally assisted housing production toward a zero level, imply a continued shortfall of net additions to the housing supply relative to household growth and mobility and housing replacement needs. Tight housing markets and inflationary housing price and rent increases would, over time, become a chronic ailment of the economy. A reduction of capacity in the supplier industries and in construction trades would develop over time. Consequently, in future year periods of reduced interest rates that might make housing more affordable for a larger segment of the population, there would probably be production bottlenecks which would quickly result in higher prices and rents.

At this time, there is still available a great deal of unused capacity that could be employed and thus help the building materials supply and residential contruction activities to remain viable. Utilization of manufacturing capacity at a 67 percent rate reflects much unused capacity in building materials production, and a 20 percent unemployment rate among construction workers speaks for itself.

To provide support for a higher level of housing production to meet needs and avoid future inflationary impacts upon the economy, there are at least two broad avenues that can be pursued. One is to lower interest rates. If there is a fear that lowering interest rates through expansion of the money supply will reignite inflation, then there should be restoration of authority and use of credit controls, such as were employed in 1980, to help bring interest rates down quickly and revive the home building industry and the economy.

The other course is to restore some of the federally assisted new housing construction programs to higher levels. The budgetary authority for federally

TABLE 8

Construction Unemployment: Annual Average and Seasonally Adjusted Monthly Unemployment: Rates and Number of Unemployed: 1978-1982

	Construction Unemployment Rate	Unemployed Persons* (thousands)
1978	10.6	516
1979	10.2	525
1980	14.2	723
1981	15.7	791
1982	20.0	1,031
1982		
Jan.	18.5	946
Feb.	18.3	943
March	18.2	941
April	19.3	1,002
May	18.9	992
June	19.5	987
July	20.3	1,048
Aug.	20.4	1,045
Sept.	22.0	1,142
Oct.	22.3	1,176
Nov.	21.8	1,147
Dec.	22.0	1,159
1983		
Jan.	20.0	1,043

*Unemployed Private Wage and Salary Workers

Source: Bureau of Labor Statistics

assisted housing programs was reduced from about $20 billion in the amount actually obligated by the Department of Housing and Urban Development in fiscal year 1982 to about $10.6 billion that HUD estimates will be committed in fiscal 1983 and a proposed $4.1 billion in fiscal 1984. With the addition of about $15 to $16 billion in budget authority to be committed in fiscal years 1983 and 1984, it would be possible to support the production of about 200,000 units of assisted rental and homeownership housing for low- and moderate-income families. This could include housing for the elderly as well as family housing, Indian housing, and rural housing. It should be borne in mind that a budget authority for housing programs would become outlays in payments to be spread over periods of thirty to forty years. The outlays before construction is completed and the projects occupied would be minimal. Some of the construction would be starting fairly rapidly -- that involving single-family homes. The rental housing would take longer to get started, and production would take from one to two years. However, there will apparently be unused capacity in the economy for several years to come. The President's Economic Report projects unemployment at 10.7 percent in 1983, 9.9 percent in 1984, 8.9 percent in 1985, and 8.1 percent in 1986. Surely, the economy has the capacity to increase the level of housing production that would take place during those years.

SUMMARY TABLE

AFL-CIO TAX PROPOSALS

	Fiscal Year ($ Billion)			
	1984	1985	1986	1984 - 1986
700 Cap	6.0	6.9	7.4	20.3
Repeal Indexing	0.0	8.9	23.4	32.3
Trim "Savings" Exclusions	0.6	1.7	3.7	6.0
Phase Down Capital Gains Exclusion	2.5	5.6	8.1	16.2
Restore Estate and Gift Tax	3.2	4.2	5.6	13.0
Foreign Tax:				
DISC	2.0	3.0	3.0	8.0
Deferral	6.0	6.6	7.1	19.7
Foreign Tax Credit	6.5	7.1	7.4	21.0
Investment Tax Credit				
Depreciation Basis Adjustment	1.3	2.4	4.1	7.8
Reduce 10% to 7%	5.6	7.1	8.2	20.9
Limit Graduated Rates to Small Corporations	1.9	2.0	2.0	5.9
Oil and Gas Depletion and Expensing of Drilling Costs	7.2	8.0	9.0	24.2
	$42.8	$63.5	$89.0	$195.3

The CHAIRMAN. Thank you very much, Henry. Due to the lateness of the hour and the fact that Secretary Regan and the International Subcommittee is waiting for me, I will not give you any questions. I will submit them to you in writing.

I would just like to make a couple of observations. In the 8 years I have been on the Banking Committee, I don't know when I have sat through a hearing where I felt the quality of the testimony from everyone was so good, well informed, well prepared; second, where I have seen such a high degree of agreement. That is unusual.

Obviously, there are differences in how you would handle things. There is certainly agreement, regardless of how it is done, that the deficits need to be brought down.

There is certainly overwhelming agreement that interest rates are still too high, even though we are glad that they have come down, they must go down further.

That is where I started in my opening statement, with those two comments, and the testimony has overwhelmingly reinforced that. I do compliment each of you three and all of the other panelists for your extremely good testimony.

Although I have cut myself off, I certainly would not arbitrarily cut my colleagues off from them asking questions if they would like to.

Senator Proxmire.

Senator PROXMIRE. Mr. Chairman, I have mercy. I won't ask you any questions. I want to congratulate you on your stamina, along with your other fine qualities. This is a great showing. You have been able to sit here since 10 o'clock and show no sign of fatigue whatsoever.

I won't fatigue you any further.

The CHAIRMAN. I have been sitting in airplane cockpits far longer over the years. I have trained for it.

Senator PROXMIRE. Sitting in an airplane cockpit is one thing. That might be quite exciting. Of course, this morning was exceptionally exciting. [Laughter.]

But I think from what I have heard and what the staff has been able to fill me on, I think you gentlemen were stressing the right thing. We have to get this deficit under control.

We have to do it. I understand in the first 3 months, the first 3 months of this fiscal year, beginning October 1, the deficit was $68.3 billion. That was for 3 months alone. That is a bigger deficit in 3 months than we had in any year, any year in our history until 1982 fiscal year.

So it is a colossal problem. I haven't seen anybody who has come up with any really satisfying proposals to really get this deficit under control, although some have tried. I think maybe one of the best is Slade Gorton, who has a very good proposal. I can't support it all entirely, but I will certainly try, Slade.

I think you are right. We have to get the deficit under control. There is no way we are going to get interest rates down unless we do.

Thank you very much. I only heard a little bit of your testimony. The part I heard, I agree with the Chairman.

The CHAIRMAN. Senator Lautenberg?

Senator LAUTENBERG. Thank you very much, Mr. Chairman, nothing.

The CHAIRMAN. Senator Gorton?

Senator GORTON. Nothing.

The CHAIRMAN. Let me conclude with one other remark. Although this has been a very long session, I explained why we had all the people in one day. I think it has been helpful with cross-pollenization.

Often we hear one segment of the testimony one day, and another the next day. To hear various viewpoints at the same timeframe I think has been very helpful.

I also would make one other closing conclusion that I made in my opening remarks as well. I think this recovery is real, but also very fragile. It could go either way, depending on what happens to those interest rates.

Once again, my compliments to all of the witnesses. Thank you very much.

The hearing is adjourned.

[Whereupon, at 2:25 p.m., the hearing was adjourned.]

[Additional material received for the record follows:]

TESTIMONY OF MALCOLM M. PRINE, CHAIRMAN OF RYAN HOMES, INC.

Mr. Chairman, I am Malcolm M. Prine, President and Chairman of Ryan Homes, Incorporated which is headquartered in Pittsburgh, Pennsylvania. Ryan Homes has been building affordable housing for more than 35 years. We operate in 24 cities in 12 states. Geographically, about one-third of our building activity can be found in the industrialized areas of the Mideastern United States; one-third of our building activity comes from the industrialized areas of the Southern Great Lakes states and one-third each from the Southeastern and Mid-Atlantic area. In 1982, we sold and build 6,500 houses with a gross sales volume of $334 million, which would make us one of the top three or four builders in the nation. We have been profitable every single year since we were founded and in the last five years paid federal taxes in excess of $56 million.

I am pleased to have the opportunity to present these thoughts to you and your colleagues which may serve to suggest the course of action the Congress and the Administration might follow to assure the continued recovery of the housing sector. As you know, 1981 interest rates were exceedingly high, inflation was rampant and the housing sector in dreadful condition.

Beginning in the second quarter of 1982, even while interest rates were in excess of 16 percent, the rumblings of recovery were being observed. As rates began to moderate throughout the third and fourth quarters of 1982, the recovery or the improvement in the rates of orders surged.

Interestingly, this strong increase in new orders was geographically well distributed throughout our system, even including some of the most depressed and high unemployment areas in Ohio and Western Pennsylvania. It is important to identify the characteristics of that improvement. It is principally located among mandatory homebuyers, that is, those people who are not now homeowners but are first time homebuyers and/or transferees who must otherwise relocate. This factor of the population has been being denied reasonable homeownership for the past couple of years and, even before rates dropped, had decided that this denial had been too excessive. As we enjoyed the 4-percent drop in mortgage rates, more and more of this segment of the population came to that same conclusion. Because government insured mortgages enjoy anywhere from a 1- to 2-percent lower interest rate than do conventional mortgages, this recovery is dominated by government insured mortgages. This means that they must be of modest price in order to qualify below the maximum mortgage amounts permitted in those government insured programs.

We believe that the above experience confirms the fact that there is indeed a very large underlying demand for housing in the first time homebuyer group and that the pent up demand in that factor is so great that it was willing to act even before rates came down. Now that rates have declined, the level of business continues at a very brisk pace and has spread into the existing or resale markets, which will fur-

ther benefit new housing by permitting move up buyers to sell their existing homes at reasonable prices and with reasonable discounts. They would then have the economic capability to make the change to the new home they have been wanting.

We have sufficient contact with the other major housing companies, in our market areas as well as in the country at large, and there is no question but that our experience has been shared by most of the other larger builders. Medium and high priced custom homebuilding has not had, as yet, a similar response. It is my belief that those sectors will also improve in direct proportion to the improvement in the resale or existing housing market.

This recovery is overwhelmingly dominated by fixed rate thirty year mortgages. The funds are coming dominantly from the capital markets. The depositories, savings and loans and commercial banks have played a minor role in supplying housing finance in this recovery. Variable rate financing is extremely unacceptable to most homebuyers and when given no other option they have elected not to purchase.

Given a continuation of the existing mortgage money supply and interest rate conditions, we believe that the housing recovery which is into its second six months will continue for the foreseeable future. We even believe that it will broaden, as I have previously stated, into the higher price ranges in which it does not yet exist.

The industry does not need artificial and costly subsidies to produce affordable housing for America. Those subsidies are temporary "quick-fix" programs which do not attack the root cause of our economic ills. These comments are not intended to suggest that the housing sector is not interest-rate sensitive; but rather, that external legislative interference in the money markets causes disruption and uncertainty which actually produce the opposite effect of what was intended.

Separating the issue of support for housing into the traditional two strategies of (1) stimulus to the economy by encouraging a housing recovery, and (2) welfare programs to make some provision for those unable to care for their own housing needs, I speak only to the former and not to the latter. The best stimulus that Congress can give to the housing recovery is to see to it that the current conditions continue to exist or, if possible, improve. If this Congress is unable to deal with its appetite for spending and extracting funds from the free market, either by taxing or by borrowing, then the housing recovery will certainly be in jeopardy.

Today, in America, slightly more than 300 builders produce nearly two-thirds of the housing sales. There is obviously a great deal of competition amoung them. Whatever the legislature can do in the nature of removing regulations, inhibitions and prohibitions to the market place will benefit the homebuyer/consumer. Whatever suggestions the Congress can make to Agencies and Departments that come under is purview, in the nature of deregulation, will be beneficial. My company has worked closely with the Department of Housing and Urban Development (HUD) and the Veterans Administration (VA) in the last two years and feels that great progress has been made in this regard. More remains to be done in this area but a good start has been made as we look forward to continuing our work. I would like to thank Senator Garn for inviting me to testify and would be pleased to do whatever else that I can to assist this Committee in performing its most valuable work.

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